

**DOES THE ROLE AND DUTIES OF THE
BUSINESS RESCUE PRACTITIONER AS
CONFERRED BY THE SOUTH AFRICAN
COMPANIES ACT 71 OF 2008 GIVE RISE TO
CONFLICTS WITH RESPECT TO THE POWERS
AND DUTIES OF DIRECTORS DURING
BUSINESS RESCUE PROCEEDINGS?**

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Abstract

The objective of this thesis is to research to what extent do the duties and powers conferred to the business rescue practitioner conflict with that of the directors during the business rescue proceedings since both of them form part of the management of the financially distressed company. In so doing, an analysis of the South African statutory provisions will be undertaken, followed by a probe into how those provisions can lead to the probable conflicts to be encountered between management and the practitioner, which can in turn considerably affect the effectiveness and success of the corporate reorganisation. In order to be able to find solutions to reduce possible conflicts, a juxtaposed analysis will be made with similarly statutory provisions in Australia, United Kingdom and United States of America.

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1. Introduction

The global financial crisis which occurred during the period of 2007 to 2009 led to a downturn of economic transactions which made the world economy collapse. The first remedial measure to curtail the detrimental effects was to prioritise the recovery of affected economies.¹ As an appropriate strategy, it has been proposed that financially perturbed companies should be placed under business rescue proceedings whereby all adopted policies will be converged towards the recuperation of the corporation's financial position. The rescue stratagem was suggested because by definition the term rescue denotes a situation where the entity will be restructured in a manner to restore it to a profitable corporation.² The rationale behind saving companies instead of liquidating them seems logical in the sense that if the entities remain in existence, jobs will be retained. With the employment level being maintained, the demand for consumption will be sustained, resulting in the production level growing proportionally which will in turn keep pace with the flow of economic activities which will render companies to be lucrative again and boost the economy in general.

In furtherance of the facilitation of corporate rehabilitation, the expertise of a bankruptcy specialist is the most valuable. Consequently an insolvency professional, generally referred as business rescue practitioner (hereafter 'practitioner'), is appointed during the reorganisation period so that he can apply his skills to the re-establishment of the financial health of the distressed company. In the United Kingdom, the culture is that an administrator, having the necessary insolvency skills, should be appointed to take over the control of the troubled business. In complete contrast, the United States of America supports that the specialist should only be hired in exceptional cases where the directors are not able to restore the liquidity position. As for South Africa, it has traditionally followed a system based on the English approach whereby a business rescue practitioner is employed to oversee and manage the affairs of the distressed company whilst the directors continue to manage the operations.³

¹ J Jay Choi and MG Papaioannou 'Financial Crisis and Risk Management: Reassessing The Asian Financial Crisis In Light Of The American Financial Crisis' at 444, available at <http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1046&context=ealr>, accessed on 14 March 2016.

² FHI Cassim *Contemporary Company Law* 2ed (2012) at 861.

³ J Rushworth 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' (2010) *Acta Juridica* 375 at 388.

It is worth noting that the obligation of the directors to continue trading will be covered in the parts 2.2 and 2.3 of this research project.

At first glance, it looks as though South Africa has incorporated a mechanism which takes the best of the dual systems of ‘debtor left in possession’ as applied in the United States of America and that of administration which is integrated in the English system. In such an approach, the directors are still involved at the operational level and can participate to a limited extent in strategic policy making, together with the practitioner administering the affairs of the company whenever it is required. The benefit of such a combined structure is that the knowledge and comprehension of the business from the directors along with the insolvency expertise of the practitioner significantly increase the prospect of an effective rescue regime.

While aligning with the international development towards the divestment of management, the South African insolvency law has catered for the role of the administrator but has nevertheless put in place appropriate safeguards to curtail his abuse of authority and excess of corporate control.⁴ The South African Companies Act⁵ (hereafter ‘Act’) provides that the management retains the corporate control but the administrator has the upper hand as he is expected by the statute to have active participation in the operations and the supervision of the business. As a consequence, the directors will no longer be left the faculty of conducting their functions without any subordination of control.⁶

1.1 Aim of the thesis

When we look closely, it could be deduced that with a dual authorities system consisting of both executive officers and the practitioner forming part of management, there is likely to be frictions arising out of the situation, resulting in a potentially hostile collaboration between the two parties which can considerably affect the efficiency of the rescue strategy. Therefore this research project will analyse the question as to whether during the business rescue proceedings, the functions and privileges assigned to the practitioner can give rise to conflicts with respect to the duties and powers of the board of directors. Accordingly, this thesis will examine the extent to which the hybrid approach has been applied in South African law and what were the issues

⁴ R Bradstreet ‘The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of the Business Rescue Practitioners May Adversely Affect Lenders’ Willingness and the Growth of the Economy’ (2010) 22 *South African Mercantile Law Journal* 195 at 212.

⁵ Act 71 of 2008.

⁶ Section 137(2)(a) and 137(2)(b).

which may arise from such system, coupled with the subsequent recommendations being made based on a jurisdictional comparative study.

1.2 Research Outline

As the success of the rehabilitation process is significantly determined by the role of the insolvency professional,⁷ the thesis will look into the relevant statutory provisions in the first chapter. In juxtaposition, an analysis of the duties and powers of the directors during the rescue period will also be undertaken. The provisions of insolvent trading are also considered in Chapter 1 because even though the executive members are still required to undertake dealings during the reorganisation proceedings, there exists the possibility that they can be sued for continuing to transact while the company is facing severe financial difficulty, even if they have obtained the consent of the insolvency expert prior to undertakings. As mentioned earlier, during the corporate rescue phase, the management and the insolvency professional will have different degrees of authority which can result in a likelihood of agitations occurring between them. Respectively this thesis will analyse the difficulties which are expected to take place between the two parties in the subsequent chapter.

Both company and insolvency law in South Africa are largely inspired from the English law, therefore it is useful to evaluate similar provisions to understand how the conflictive predicament has been eradicated between the parties in that jurisdiction. As another criterion for comparison, the provisions in Australia can be used to make recommendation as the country has an analogous system of administration to South Africa, apart from also being a Commonwealth jurisdiction.⁸ Further, the United States of America should be used as benchmark because the South African insolvency law has been significantly motivated by and derived from Chapter 11 of its Bankruptcy Code of 1978; and therefore it would be proper to make an analysis of its mechanisms. Thus in order to be able to probe appropriate solutions, in Chapter 3, we will make a comparative study with the aforementioned countries, namely Australia, United Kingdom and the United States regarding their provisions on the role, functions and prerogatives of the bankruptcy specialist and those of directors during the

⁷ R Bradstreet 'The New Business Rescue: Will Creditors Sink Or Swim?' (2011) 128 *South African Law Journal* 352 at 374.

⁸ P Kloppers 'Judicial Management-A Corporate Rescue Mechanism In Need Of Reform?' (1999) 10 *Stellenbosch Law Review* 417 at 420.

corporate restructuring period along with the provisions of insolvent trading. Based on a critical analysis of the cross jurisdictional provisions, we will make appropriate recommendations in Chapter 4.

2. Chapter 1: South African statutory provisions

One of the purposes of the South African Companies Act as set out in the section 7(d)⁹ is to ensure the survival of the business,¹⁰ resulting in the protection of jobs which is an essential element in developing economies.¹¹ Taking into account the societal benefits an effective restructuration procedure can bring, it has been felt that the assistance of an insolvency specialist would be appreciated in aiding the corporate recovery.¹² Accordingly the Act provides for the appointment of practitioner who will takeover full corporate control during that period although the directors will continue to form part of the management.¹³

The reasoning behind the substitution of control is that if a company becomes insolvent, it is possibly due to a directorial failure and therefore the same managers should no longer be entrusted with managerial responsibility.¹⁴ Hence, upon being aware that there is a situation of severe insolvency arising, management is required to duly assess whether it is a viable option to continue trading despite the financial distress.¹⁵ In the circumstances where it has been found that the directors were acting in bad faith, management can be punished for insolvent trading. However, it might occur that a company finds itself in acute trouble due to external factors even if the directors were not at fault and have carried out their duties diligently.¹⁶

The objective of this thesis is to appreciate whether the role and prerogatives conferred by the South African Companies Act provisions to the practitioner conflict with the duties and powers of directors during the corporate reorganisation phase. Accordingly this chapter will cover the provisions of the Act in relation to the requirement of appointing a rescue practitioner coupled with the duties and powers of insolvent professional and management. Finally, the insolvent trading provisions will be explored.

⁹ The subsection provides that one of the purposes of the Act should be to reiterate the notion of business as a way to achieve economic and social benefits.

¹⁰ Kloppers op cit (n8) 418.

¹¹ A Loubser 'Business rescue in South Africa: a procedure in search of a home?' 40 *Comparative and International Law Journal of Southern Africa* (2007) 152.

¹² Ibid.

¹³ Section 137(2)(b).

¹⁴ R Goode 'Principles of Corporate Insolvency Law' 3rd ed (2005) 328.

¹⁵ JH Rochman 'Outline of Proposed United Kingdom Insolvency Legislation' (1985) 90 *Commercial Law Journal* 49 at 51.

¹⁶ V Finch 'Control and co-ordination in corporate rescue' (2005) 25 *Legal Studies* 374 at 387.

2.1 Requirement to appoint a practitioner during business rescue

Section 128(1)(b)(i) of the Act provides that in order to ease the corporate recuperation of a troubled company, business rescue proceedings must be initiated, entailing a short-term supervision and management of the business. The oversight necessitated for the company to be able to perform financially will be undertaken by an appointed practitioner who can be constituted of one person or more.¹⁷ The mode of the appointment of the practitioner depends on which party has applied for the restructuration process to be launched. In the event that the directors adjudicate that it is proper to place the company under rescue, they will have the privilege of choosing a consenting practitioner who should meet all the requisite qualifications.¹⁸ Alternatively, if an affected party has applied to court seeking a judicial order to have the rescue proceedings begin, upon positive findings, the court will appoint the practitioner provisionally.¹⁹ In this specific scenario, the choice of the interim practitioner will be designated by the aggrieved person who made the application, which needs to be substantiated by the approval of independent creditors.²⁰

The ability of the practitioner is greatly influenced by his professional qualification which will decide the fate and independence of a corporate reorganisation.²¹ In order to stabilise the financial health of an entity, it is a prerequisite that the practitioner has a bankruptcy background. Respectively, the practitioner should be in a legal, accounting or in a business management field and he should also be a member in good standing with a professional body as per the accreditation²² and licensing²³ requirements of the Companies and Intellectual Property Commission (hereafter 'Commission'). The practitioner should not be subject to any disqualification from acting as a director of the entity²⁴ or have been imposed a probation order subsequent to not carrying out his duties correctly as director of the company previously.²⁵ He should also not be related to any person who was disqualified for not undertaking his directorial

¹⁷ Section 128(1)(b).

¹⁸ Section 129(3)(b).

¹⁹ Section 131(5).

²⁰ Section 131(5).

²¹ Bradstreet op cit (n7) 374.

²² Section 138(1)(a).

²³ Section 138(1)(b).

²⁴ Section 138(1)(d).

²⁵ Section 138(1)(c).

duties properly in the company.²⁶ Most importantly, the practitioner need not have any kind of affinity with the business which might give the impression to any person that his integrity, impartiality and objectivity have been compromised.²⁷

2.1.1 Duties of the practitioner

The main aim of engaging a company in business rescue proceedings is to reorganise the corporate affairs by developing and adopting a rescue plan which will increase the possibility for the company to continue trading in the foreseeable future.²⁸ Thus it can be deduced that the primary duty of the insolvency practitioner is to put in place the best strategies after consultation with the relevant stakeholders so as to ensure that he succeeds in efficiently improving the financial position of the entity. The Act provides that if the rescue proceeding has not ceased within three months from its initiation, the practitioner is required to give a report on the advancement of the process until it comes to an end.²⁹

In the next subsections, we will scrutinise the duties of the bankruptcy expert relating to his reporting obligations, the strategies to be implemented and the commitment to exercise his performances in good faith and with an expected degree of care, skill and due diligence.

2.1.1.1 Reporting to relevant authorities and investigation in the scope of the rescue

Upon employment, the practitioner has the obligation to inform all relevant regulatory authorities that the business is placed under rescue procedures.³⁰ Afterwards, he is required to inquire into the assets and financial situation of the business as soon as it is suitable to do so.³¹ Subsequent to such examination, he must assess whether there is a reasonable chance of the company being rescued following a prospective restructuring strategy.³² If at any time he concludes that there is no possibility of a corporate recovery, the practitioner must respectively inform the court and all affected persons about the situation.³³ Also, as stated above, it is

²⁶ Section 138(1)(f).

²⁷ Section 138(1)(e).

²⁸ Section 128(1)(b)(iii).

²⁹ Section 132(3)(a).

³⁰ Section 140(1)(A).

³¹ Section 141(1).

³² Section 141 (2)(a).

³³ Section 141(2)(b).

anticipated from the practitioner to provide a regular update on the evolution of the proceedings. A supplementary duty is imposed on the practitioner, who after his appointment is considered as an officer of the court, to report to the judicial institution about the extent to which the court order and rules made have been applied.³⁴

2.1.1.2 Designing the rescue scheme and promoting interest of stakeholders

In order to administer the corporate operations, the practitioner will have to develop and implement a business rescue plan which he will have to follow.³⁵ The practitioner is entrusted with the responsibility of designing the scheme³⁶ after consultation with all affected stakeholders regarding their views and benefits. This exigency goes in line with the fact that the business rescue proceedings should be undertaken in such a way that the rights and interests of relevant parties are balanced in accordance with the section 7(k) of the Act.³⁷ Thus, although the practitioner is appointed mainly to protect the interests of the creditors, he is expected to take into account the interests of other stakeholders.

The Act has put in place another statutory provision corroborates with the stakeholder inclusivity approach by stipulating that any aggrieved party may apply for a court order demanding that the practitioner to equilibrate the various participants' viewpoints by requiring him to provide security with terms and amount depending on court determination.³⁸ The imposition of security has been an imbedded principle of the South African insolvency law compelling that judicial manager or trustee, and in our case, the practitioner who in the similar position, to provide such guarantee.³⁹ This notion is reiterated as an outcome of the wide powers and position of trust which the practitioner holds.⁴⁰ In fact the King Code⁴¹ suggests that the appointed practitioner should provide security amounting to the value of the corporate assets.⁴²

³⁴ Section 140(3)(a).

³⁵ Rushworth op cit (n3) 393.

³⁶ Section 140(1)(d).

³⁷ A Loubser 'The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)' (2010) *South African Law Journal* 501.

³⁸ Section 130(1)(c).

³⁹ Loubser op cit (n37) 508.

⁴⁰ Ibid.

⁴¹ Institute of Directors 'King Code of Governance for South Africa' (2009), recommendation 2.15.4.

⁴² Loubser op cit (n37) 508.

If there are remote chances for the entity to recover financially, the practitioner should, as a last resort, at least target to generate a better return at least for the creditors or for the shareholders than what would have been obtained as a consequence of an immediate liquidation.⁴³ Hence the practitioner should do his best to maintain the company's value so that one or both of these stakeholders groups are not put at a colossal disadvantage. If the corporate reputation is preserved, the capital gain and dividend of the shareholders will be maintained. As for the creditors, if the goodwill is maintained, the life of the company will be prolonged and they will benefit in terms of an increased likelihood for them to get back their investment.

2.1.1.3 Same duties as directors

The duties of the practitioner are more onerous than those of the directors since he has to carry out the obligations of the managers in addition to his own set of responsibilities due to the management displacement.⁴⁴ For that reason, section 140(3)(b) of the Act stipulates that the practitioner has the responsibilities, duties and liabilities of a director of the company in accordance with sections 75, 76 and 77 of the Act with regard to personal financial interests, standards of conduct and certain liabilities.

Like management, the practitioner will be expected to disclose at any time any of his personal financial interest.⁴⁵ Similarly, section 76 specifies that the practitioner should not consciously cause harm to the business.⁴⁶ It is further stipulated by the same provision that the practitioner is mandated to carry out his tasks in good faith,⁴⁷ in the best interests of the company.⁴⁸ He is additionally instructed to apply an expected degree of care, skill and diligence when performing his functions as would be anticipated by another practitioner having the same knowledge and expertise.⁴⁹ The practitioner is also statutorily prescribed to rely on the performance and advice of other specialists unless he has reasonable grounds to suspect that it would not be wise to depend on such judgement.⁵⁰

⁴³ Section 128(1)(b)(iii).

⁴⁴ Rushworth op cit (n3) 393.

⁴⁵ Section 75.

⁴⁶ Section 76(2)(a)(ii).

⁴⁷ Section 76(3)(a).

⁴⁸ Section 76(3)(b).

⁴⁹ Section 76(3)(c).

⁵⁰ Section 76(4)(b) and (5).

These duties will be elaborated in the section regarding the duties of directors during rescue proceedings.

Given the extensive powers of the practitioner, it stands to reason that he should be correspondingly accountable for his actions;⁵¹ and thus he should strictly abide by his duties with the requisite level. But it has been submitted that the standards of duties for practitioners should be lower than the ones imposed on directors with respect to the same duties since a high threshold would prevent the practitioner from taking certain necessary decisions outside the functional scope of a manager.⁵²

2.1.2 Powers of Practitioners

Since the corporate managerial prerogatives change hands from the existing management to the practitioner,⁵³ the latter will be empowered to exercise his authority with respect to the transactions of the business, the dismissal of directors and appointment of officers. In the following subsections we will look into these powers together with the repercussions which can be occasioned if they are abused.

2.1.2.1 Removal and Appointment and of directors and officers.

The practitioner is vested with the power to dismiss any individual who is part of management and is subsequently entitled to appoint any person to fill this or any other vacancy.⁵⁴ But these appointments cannot be made with respect to a person who has any other relationship with the business or who is related to persons having a corporate relationship with the entity cannot be employed because of people's perception of him being biased.⁵⁵

The entitlements of the practitioner would also comprise of him having the capacity to assign any of his powers or functions to an individual who forms or previously formed part of management.⁵⁶ This privilege upholds the provision that a director must exercise his functions subject to the practitioner's authority;⁵⁷ implying that the practitioner is the one with ultimate

⁵¹ Bradstreet op cite (n4) 209.

⁵² Ibid.

⁵³ Section 140(1)(a).

⁵⁴ Section 140(1)(c).

⁵⁵ Section 140(2).

⁵⁶ Section 140(1)(b).

⁵⁷ Rushworth op cit (n3) 392.

control over the management.⁵⁸ However it is not clear whether the substitution of control would mean a full divestment of management.⁵⁹

2.1.2.2 Approval and abuse of powers of the practitioner

It is stated by the Act that no legal or enforcement proceedings can be initiated against the company's assets except if the practitioner agreed in writing that such remedy can be sought.⁶⁰ Thus the practitioner should judiciously appreciate when it will be wise to give his approval because as per the section 134(2)(b) of the Act, the practitioner should not withhold his consent unreasonably, with respect to the circumstances of the company. If it is proved that the refusal from the practitioner to give his consent is unjustified, it can be construed to be a misuse of his discretion. As such, preventive measures have been provided to control the wide powers in the form of section 77 which specifies that a practitioner may be liable under the common law for any loss sustained by the company as a consequence of a breach of his duty, which can also result in a delictual claim. Therefore the practitioner will be punished for gross negligence or bad faith emanating from the exercise of his performances.⁶¹

Liability can still be asserted in the event the practitioner had been an accepting and contracting party to transactions which have been dealt by a person who acted outside his authority or had intention to defraud, or whereby the activities were undertaken recklessly. It should be noted that the appointed practitioners will be jointly and severally liable altogether for the same action. However, the practitioner may exonerate himself by proving that he acted honestly and reasonably, and taking into account the circumstances of the case. He can also seek protection under the business judgement rule as provided by the section 76(4) of the Act (the rule will be explained in section 2.3.2 of the dissertation). But if there are no reasonable grounds to justify the gross mismanagement by insolvency practitioner, under such circumstances he may be removed from office.

⁵⁸ Bradstreet op cit (n4) 200.

⁵⁹ Bradstreet op cit (n4) 199.

⁶⁰ Section 133(1)(a).

⁶¹ Section 140(3)(c).

2.1.2.3 Removal of practitioner

By way of application to the court by an aggrieved person, if it is arbitrated that it is appropriate to set aside the company's resolution regarding the initiation of the business rescue proceedings or that the aptitude of the practitioner is defective, the judicial institution will order the revocation of the appointed practitioner.⁶² A practitioner can be dismissed on various grounds, namely of incompetency, his engagement in illegal doings,⁶³ or his inability to perform requisite functions and the unlikelihood to regain that capacity within a reasonable time.⁶⁴ He can also be removed on the basis that he does not satisfy the requirements of section 138⁶⁵ which will imply that he is no more a member of a professional body which is accredited by the Commission, he has been the subject of a probation order, he has been disqualified from being a director or he has an affinity of a conflictive nature with the entity.⁶⁶ The practitioner can also be dismissed for cause that he is not independent to management.⁶⁷

The removal of the practitioner can be executed for failure to exercise his duties properly⁶⁸ or incapability to perform his duties with the required degree of care⁶⁹ or simply because he lacks the necessary skills to act with respect to the company's circumstances.⁷⁰ It has been defended that if it is vital for the practitioner to have certain specific requisite skills, it should be set out as a pre-condition at the outset of the appointment and not after his appointment, as his competence will determine the success of the rescue plan.⁷¹ Nonetheless, with a multitude of grounds for dismissal, it is relatively easy to remove the practitioner and this is why it is proper to entrust the court with this responsibility.⁷² Hence it can be deduced that the practitioner will be subject to the control of the court; and according to the judiciary, he is expected to act impartially and honestly⁷³ or otherwise he can be removed from his post. In

⁶² Section 130(6).

⁶³ Section 139(2)(c).

⁶⁴ Section 139(2)(f).

⁶⁵ Section 130(1)(b)(i).

⁶⁶ Section 139(2)(e).

⁶⁷ Section 130(1)(b)(ii).

⁶⁸ Section 139(2)(a).

⁶⁹ Section 139(2)(b).

⁷⁰ Section 130(1)(b)(iii).

⁷¹ Loubser op cit (n37) 507.

⁷² Bradstreet op cit (n4) 208.

⁷³ Cassim op cit (n2) 889.

fact in the cases of *Ex p James*⁷⁴ and *Re British American Racing (Holdings) Ltd*⁷⁵, the court adjudicated that ‘the conduct of the practitioner can be opened to review by it’.⁷⁶

In case the practitioner dies, resigns or his appointment is revoked, the oversight of the business is being substituted by a new practitioner.⁷⁷ As replacement, an alternate practitioner who meets all requisite specifications will be appointed subject to the recommendation or consent of the majority of independent creditors’ voting interests which have been represented to the court.⁷⁸ This provision is supported on the assumption that creditors will be represented which might not be the case since they can be reluctant to incur the resulting costs.⁷⁹ Further, it is worth noting that in the instance where there is no representation of creditors’ interests,⁸⁰ there is no substituted inclusion of shareholders or employees to be represented.

2.2 Role of directors during business rescue

The existing management is not automatically removed during the rescue proceedings⁸¹ and hence has to perform some residual functions. These duties do not constitute part of the decision making and control, except and to the extent the practitioner has delegated such prerogatives.⁸²

2.2.1 Duties of directors

As the directors are still employed as the agents of the entity, they are still bound by the fiduciary duty, requiring them to act in the best interests of the company. Also, irrespective of the solvency situation of a corporation, the executive officers are expected to manage the business in such a way so as to promote high standards of corporate governance as per the section 7(b)(iii) of the Act, which is mainly founded under the principle of balancing the various stakeholders interests. Also, there are certain criteria which are to be respected by the managers when performing their functions, such as applying a requisite degree of due care,

⁷⁴ (1874) 9 Ch App 609.

⁷⁵ [2005] 2 BCLC 234 (Ch D) 248f.

⁷⁶ Cassim op cit (n2) 889.

⁷⁷ Section 139(3).

⁷⁸ Section 130(6)(a).

⁷⁹ Loubser op cit (n37) 507.

⁸⁰ Ibid.

⁸¹ Loubser op cit (n37) 502.

⁸² Rushworth op cit (n3) 392 and section 137(2)(a) and (b).

diligence and skill. However the degree of commitment to these duties is reduced correspondingly to the extent to which the functions have been taken away from these officers during the rescue proceedings. The obligations of the directors during the reorganisation phase will be covered below.

2.2.1.1 Duty as officers of the company and protection of the interests of stakeholders

There is no settled agreement about the basis of the legal relationship between management and the company.⁸³ Some have opined that directors are the managing partners⁸⁴ and they are thus empowered with the capacity to manage the financial affairs of the business⁸⁵ whilst others would view the managers as being the agents, more particularly as trustees.⁸⁶ It is implicitly understood that these officers are required to undertake both roles simultaneously. As trustees of the company, the directors are anticipated to perform their duties with the sole aim of benefitting the troubled entity.⁸⁷ In the same fashion the corporate assets should be utilised to maximise the returns of the business.⁸⁸ In fact, in practice, the executives usually adopt the enlightened shareholder value approach which still focuses strongly on profit maximising.⁸⁹ However it is recommended by the regulatory framework of King Code III that a stakeholder inclusivity attitude is more suitable for companies, whether they are financially distressed or not.⁹⁰

All companies incorporated and resident in South Africa have to follow the King Code III guidelines on corporate governance.⁹¹ Accordingly the managers of all entities, irrespective of the liquidity status, should practice sound corporate governance as a way to sustain growth in the future.⁹² It is worth noting that the compliance of the Code is strictly required for companies listed on the Johannesburg Stock Exchange; and those entities which are not listed, the institution cannot do much to enforce the principles stipulated. The report accentuates that directors should take appropriate measures to overcome the financial difficulty during the

⁸³ Cassim R Contemporary Company Law 2ed (2012) at 412.

⁸⁴ Ibid.

⁸⁵ Cassim op cit (n83) 413.

⁸⁶ Ibid.

⁸⁷ Cassim op cit (n83) 412.

⁸⁸ Ibid.

⁸⁹ Cassim op cit (n83) 495.

⁹⁰ Institute of Directors op cit (n41), recommendation 1.1.9,

⁹¹ King Code of Corporate Governance for South Africa 2009.

⁹² Cassim op cit (n83) 473.

business rescue proceedings.⁹³ The King III Report adopted the triple bottom line approach which consists of operating the company in a manner where appropriate responsibility is accounted for economically, socially and environmentally.⁹⁴ It is further advocated by the framework that the executive officers should adopt a stakeholder inclusive approach⁹⁵ which recognises the possible benefits to be generated for a large group of affected parties in the long run.⁹⁶ Thus it can be said that corporate governance is one of the measures which can assess the competency of management.⁹⁷

However, it can be commented that directors who are still employed by the company, should focus on protecting the interests of the corporation by safeguarding the rights of the shareholders. In this regard, in the case of *Percival v Wright*,⁹⁸ the court coined the principle that a director only owes a fiduciary duty towards his company and not to anyone else. However, the South African Appellate Division observed in *Sammel v President Brand Gold Mining Co Ltd*⁹⁹ that when the business is insolvent, management should focus on the rights and interests of the creditor instead of the shareholders. In spite of this, it was not customary for the South African courts to impose a duty on directors to act in the interests of creditors, irrespective of the insolvency situation.¹⁰⁰ But it has been long advocated that directors should specifically owe a fiduciary duty to creditors when a company is found in an insolvent position.¹⁰¹ It was strongly argued by some that the fiduciary duty towards the creditors has persisted throughout the life of the company, regardless of the corporate financial health in the disguise of managers having the responsibility to account for stakeholders' viewpoint and wishes (including creditors) before taking a decision.¹⁰²

⁹³ Cassim op cit (n83) 481.

⁹⁴ Cassim op cit (n83) 495.

⁹⁵ Ibid.

⁹⁶ Ibid.

⁹⁷ JH Farrar 'Directors' Duties and Corporate Governance in Troubled Companies' (2001-2002) 8 *Canterbury Law Review* 99.

⁹⁸ 1902 2 Ch421.

⁹⁹ 1969 3 SA 629 (A).

¹⁰⁰ JSA Fourie 'Limited Liability And Insolvent Trading' (1994) 5 *Stellenbosch Law Review* 148 at 163.

¹⁰¹ Ibid.

¹⁰² JS McLennan 'Wrongs to companies: Condonation' (1998) 115 *South African Law Journal* 129 at 132.

2.2.1.2 Duty of care, skill and diligence

During the proceedings, the directors still need to comply with the requirements concerning personal financial interests.¹⁰³ Section 76(2)(a)(i) of the Act describes that management should avoid having a conflict of duty and personal interests with the company.¹⁰⁴ To the extent that the executive officers carry out managerial functions subject to the direction of the practitioner where applicable, they are exempted from abiding by the general standards required for directors' conduct in accordance with section 76 and from liabilities as listed in section 77 with the exception of sections 77(3)(a), (b) and (c)¹⁰⁵ regarding the duty of care, skill and diligence. The nature of the duties of good faith, loyalty and of reasonable care and skills are 'mandatory, prescriptive and unalterable' from which the directors cannot contract out.¹⁰⁶ The objective of this high benchmarking is to raise the standards of corporate and directorial behaviour.¹⁰⁷ It can be noted that the South African provisions on the duties of directors were significantly inspired by English precedents of the late 1800s and early 1900s.¹⁰⁸

The South African courts adopted a conservative approach towards directors' duty of care, skill and diligence whereby the case which was adjudicated in 1980, *Fisheries Development Corporation of SA Ltd v Jorgensen*,¹⁰⁹ is still the leading case on the subject. The case identified the principle that the application of these duties will depend considerably on the nature of the company's business and on the degree to which the director has been assigned a particular obligation. The judges also remarked that a director need not be equipped with a special business acumen or to have appropriate experience in the business of the company, but should exercise due care to the extent which can reasonably be expected of a person having the same knowledge and experience as him. Also the director is not liable for mere errors of judgment. In addition, the court noted that a director is required to trust that other officers are doing their job correctly unless they have reasonable justifications for suspecting the opposite. Therefore it means that the director is bound to rely on the information, judgement and advice

¹⁰³ Section 137(2)(c).

¹⁰⁴ J Du Plessis 'A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia' (2010) *Acta Juridica* 263 at 267.

¹⁰⁵ Section 137(2)(d).

¹⁰⁶ Y Joubert and J Calitz 'To Be Or Not To Be? The Role Of Private Enquiries In The South African Insolvency Law' (2014) 17 *Potchefstroom Electronic Law Journal* 888 at 925.

¹⁰⁷ Joubert and Calitz op cit (n106) 925 at n96.

¹⁰⁸ Du Plessis op cit (n104) 285.

¹⁰⁹ 1980 (4) SA 156 (W) at 156.

of the relevant professionals, unless there are reasonable grounds for questioning same. It can hence be concluded he is entitled to accept data and advice after due consideration.

Since the standard to which a director is expected to live up to, is subjective to someone occupying the same role and having similar knowledge and expertise, in case of litigation, the court will have to determine beforehand what will be the exact parameters of the standards to be set.¹¹⁰ According to the value judgement of the court, the judicial institution will be able to assess whether the conduct of the manager was proper.¹¹¹

2.2.1.3 Documentary records

Management is required to respond to every query of the practitioner at all times during the proceedings; in particular they should provide information about the company's financial position¹¹² by arranging for all relevant documentary records as soon as the proceedings are initiated.¹¹³ In this concern, the statement of affairs will help the practitioner to assess the business' financial condition and assist him in the development of the business rescue plan.¹¹⁴ Additionally, the directors should update the practitioner about the whereabouts of the documentary evidences.¹¹⁵

In case the proceedings have not yet been started, and the practitioner deduces from evidences that there were voidable transactions or a failure by the directors to perform any material corporate obligation, he must instruct the executive officers to take any requisite remedial measures.¹¹⁶ If there is proof that there has been reckless trading, he must order management to take any necessary steps to rectify the matter and he should instantaneously forward the evidence to the appropriate authority for further investigation whereby the possibility of prosecution may be entailed.¹¹⁷

¹¹⁰ Du Plessis op cit (n104) 269.

¹¹¹ Ibid.

¹¹² Section 137(3).

¹¹³ Section 142(1).

¹¹⁴ Rushworth op cit (n3) 395.

¹¹⁵ Section 142(2).

¹¹⁶ Section 141(2)(c)(i).

¹¹⁷ Section 141(2)(c)(ii).

2.2.2 Powers of directors

The managers no longer have discretionary privileges but they still have residual powers left. Even if their powers may be restricted by the insolvency's expert authority, the officers will still attend the board meetings, and be involved at operational and strategic level.

2.2.2.1 Continue to trade and still involved in the decision making process

The officers comprising of the pre-rescue management, continue to trade on a daily basis. But the approval of practitioner is required, wherever it is reasonable to have his consent so that certain transactions can be undertaken by the director. Thus the dealings will be valid only upon the permission of the rescue expert, absent which they will be void.¹¹⁸

The managers can be conferred additional entitlements than usual, subject to the delegation of the practitioner's powers,¹¹⁹ in which seems to vary from a scenario to another one. Thus, the degree of participation of directors in the strategic policy formulation will be contingent on the instruction of the practitioner.¹²⁰ Consequently it can be argued that the directors might not impact on decisions taken if they have a passive role by only attending the meetings but are not entitled to a say.

2.2.2.2 Liability of directors

As discussed earlier, the directors are still required to abide by the duties listed in the section 77(3). Therefore in case the officers failed to perform their functions correctly in this respect, they might face an order declaring the executive to be delinquent which might in turn to the disqualification and dismissal from office.¹²¹

The liability of the directors subsists in the scenario where costs are incurred by the company as a result of a director carrying out any dealings or actions on behalf of the company despite knowing that he does not have the requisite capacity.¹²² Management will still be liable for any damages caused if it acquiesced undertaking business recklessly, with gross negligence,

¹¹⁸ Section 137(4).

¹¹⁹ Section 137(2)(a)

¹²⁰ Rushworth op cit (n3) 392.

¹²¹ Cassim op cit (n83) 432.

¹²² Section 77(3)(a).

for any fraudulent motive or with the mental aim of defrauding any individual.¹²³ Liability will come also be into play if a director has participated in any action or omission where he had knowledge that the nature of the dealing is for fraudulent purposes and has resulted in the business sustaining losses.¹²⁴

2.2.2.3 Removal from office

By way of application to the court, any affected person¹²⁵ or the practitioner can remove a director on the basis that the latter failed to satisfy the requirements of Chapter 6 of the Companies Act regarding the provisions of business rescue¹²⁶ or has impeded the practitioner to perform his duties¹²⁷ or prevented the latter from managing the business correctly.¹²⁸

2.3 Insolvent trading

During the rescue process, directors maintain the operations but often some of the dealings might be of a risky nature; and as a consequence, the assent of the practitioner will be needed in order to proceed with such undertakings. It can be perceived by third parties that the directors are being reckless and negligent by transacting when they should instead refrain from trading during the time the entity is facing severe solvency difficulties. Thus, even after obtaining the accord of the practitioner, it might occur that directors are prosecuted for insolvent trading. In this regard, it is important to consider the provisions of the Act on the topic.

Herzberg is of the opinion that the aim of the insolvent trading provisions is to ensure that management stops trading promptly and initiates proceedings when it is reasonably felt that the business can no longer pay its current expenses as and when they fall due.¹²⁹ In South Africa, section 22(1)(a) of the Act provides that a business should not undertake any dealings recklessly, with gross negligence or with the intention to defraud any individual. Additionally,

¹²³ Section 77(3)(b).

¹²⁴ Section 77(3)(c).

¹²⁵ Section 137(6).

¹²⁶ Section 137(5)(a).

¹²⁷ Section 137(5)(b)(i).

¹²⁸ Section 137(5)(b)(ii).

¹²⁹ Herzberg 'Insolvent Trading' (1991) *Company and Securities Law Journal* 285.

the Section 22(1)(b) stipulates that an entity is not required to trade under insolvent circumstances.

Sections 77(3)(b) and (c) reiterate section 214 of the Act by stating that a director could be held liable if he was aware that a fraudulent action which was initiated would subsequently lead to a loss for the company.¹³⁰ Even if the executive officer is not aware of the legal consequences of the process of the dealings but knew that the conclusion of the transactions would be carried out fraudulently, the director will still be liable.¹³¹ In order to prove the fraudulent nature of the activities, the plaintiff should prove the causal link that the loss suffered was an outcome of the reckless trading.¹³² The aggrieved parties face who want to seek remedy in terms of this principle, encounter procedural and substantive difficulties in proving their case.¹³³ The greatest problem experienced by creditors is that they have a considerable onus in convincing the court that at the time the particular debt was incurred, there were no reasonable grounds to expect that the company could repay the current expenses.¹³⁴ To prove the inability of the business to pay its debts, these creditors should rely on records of the company, such as the financial statements and the cash flow position which can be obtained with the assistance of management, who is the party the creditors are suing.¹³⁵

2.3.1 Penalties

An action to determine the liability of management can be initiated by any aggrieved party who suffered any damages as a result of transactions being undertaken negligently.¹³⁶ The penalty is normally the civil consequence which will be entailed, similarly to any breach of the Act's provisions.¹³⁷ In fact section 424 of the Companies Act provides that personal liability on directors can be imposed if the latter took cognisance of any fraudulent action or intention. But

¹³⁰ E Levenstein 'Reporting Obligations of directors in terms of the new Companies Act, No. 71 of 2008 – Reckless trading and personal liability' July 2013 available at <http://www.werksmans.com/wp-content/uploads/2013/07/Legal-Brief-July-Eric-Levenstein.pdf>, accessed on 14 March 2016.

¹³¹ K Van Der Linde 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *South African Mercantile Law Journal* 439 at 443.

¹³² H E Wainer 'The New Companies Act: Peculiarities And Anomalies' (2009) 126 *South African Law Journal* 806 at 813.

¹³³ Fourie op cit (n100) 157.

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ K Van Der Linde op cit (n131) 443.

¹³⁷ Section 218(2).

it is provided by the Act that both civil and criminal liabilities are imposed on the directors with respect to the same prohibited actions.

2.3.2 Remedies

In *Carbon Developments*,¹³⁸ the then Appellate Division remarked that insolvent trading can easily happen and should not be treated as a societal crime. Hence, directors are duly expected to perpetuate trading if it is proper to do so and they can justify that their decision was well thought out, even if the risk of worsening the insolvency phase can engender their liability.¹³⁹ It had been argued that if there has been no intention to defraud emanating from the directors, there is no justification for the business to cease trading whilst being factually insolvent.¹⁴⁰

Another defence which can be available to the managers who are accused of insolvent trading is to rely on the business judgement rule. South Africa has established its particular version of the business judgement rule,¹⁴¹ often also referred as the safe harbor provision which has been incorporated in section 76(4) of the Act. In order to have recourse to this remedy, management should show that it has taken all necessary measures to be informed about the matter in question;¹⁴² that it or a related party has no personal interest in the matter.¹⁴³ Management also needs to prove that it has taken decision based on the opinion of a designated expert.¹⁴⁴ It is to be noted that the application of the rule applies to not only to business decisions and judgement which means that the rule extends its' protection to directors with respect to any decisions, even if the strategy adopted has a disastrous impact on the company.¹⁴⁵ But such a shield would not apply in the case of reckless trading or where fraudulent intention can be largely proved.¹⁴⁶

¹³⁸ *Exparte de Villiers & another NNO: In re Carbon Developments (Pty) Ltd (in liquidation)* 1993 (1) SA493 (A).

¹³⁹ *Rochman op cit* (n15) 51.

¹⁴⁰ *Wainer op cit* (n132) 812.

¹⁴¹ JH Farrar 'Directors' Duties of Care' (2011) 23 *Singapore Academy of Law Journal* 745 at 746.

¹⁴² Section 76(4)(a)(i).

¹⁴³ Section 76(4)(a)(ii).

¹⁴⁴ Section 76(4)(b).

¹⁴⁵ *Cassim op cit* (n83) 566.

¹⁴⁶ *Ibid*.

In addition section 77(9) of the Act stipulates that a director may be spared liability by the court in any proceedings if it appears that he has acted honestly and reasonably and took into account the circumstances of the case.¹⁴⁷ Therefore if there is evidence that the directors acted in good faith, without being biased by any personal benefits and have only considered what is in the best interest of the company, they might seek to defend themselves in terms of this provision. But if the court finds that one of the requirements has not been met, the rule will be of no use and the director will be considered to be liable.¹⁴⁸

In the event the executive officers have incurred supplementary debts when the entity was on the verge of bankruptcy, the Court will take into account some factors in determining the bad faith and mischievous intent of the officers. In the case of *Philotex v Snyman*,¹⁴⁹ it was highlighted that some of the pertinent elements to be considered whilst trading in factually insolvent circumstances are the clarity, commitment, extent and duration of future source of funding before incurring additional debt. The listed components will guide the insolvent company on how to suitably achieve a practical and commercial solution.¹⁵⁰

¹⁴⁷ E Levenstein 'South Africa: The new Companies Act, No. 71 of 2008 – Reckless Trading And Personal Liability Of Directors' May 2011 Available at <http://www.mondaq.com/southafrica/x/140688/Corporate+Company+Law/The+New+Companies+Act+No+71+Of+2008+Reckless+Trading+And+The+Personal+Liability+Of+Directors>, accessed on 14 March 2016.

¹⁴⁸ A Greenhow 'The Statutory Business Judgment Rule: Putting the Wind into Directors' Sails' (1999) 11 *Bond Law Review* at 57.

¹⁴⁹ *Philotex (Pty) Ltd & others v Snyman & others* 1998 (2) SA 143 (SCA).

¹⁵⁰ Wainer op cit (n132) 812.

3. Chapter 2: Conflicts between the practitioner and directors

This Chapter will address the issues which may arise with respect to the directors still forming part of management during the rescue proceedings whilst the practitioner has ultimate directorial control. The major cause of frictions between the two parties is likely to result from lack of co-ordination which is traditionally influenced by diverging interests, perceptions and motivations on the side of each party.¹⁵¹ The following sections will analyse the various reasons why conflicts can arise between the directors and the practitioner.

3.1 Use of information

Essentially practitioners should possess the requisite expertise in insolvency matters including laws and processes relating to corporate restructuring. However, even though they keep abreast of changes in insolvency law and turnaround strategies, they do not have a thorough comprehension of the internal processes and any particular company's activities.¹⁵² Mayson opines that since the rescue practitioner has to take over the management and oversight of the business, information should be provided to him.¹⁵³ The appropriate source would be the officers of the company who are well acquainted with the business, its history and its culture.¹⁵⁴ Having access to such information would enable the bankruptcy expert to prepare a substantive rescue plan which will be proposed to the creditors based on the data provided.¹⁵⁵ However, a predicament which the administrator might face is that at times a large amount of information might be required within a short timeline which will not be feasible for the directors to respond appropriately due to time constraint.¹⁵⁶

It can be contended that although information and assistance of directors are provided to the practitioner, the construal of the data will be subjective to him, which may imply the possibility of misunderstanding. Despite knowing the inherent corporate environment, management cannot pressurise the practitioner to follow a specific line of thought since it has

¹⁵¹ Finch op cit (n16) 380.

¹⁵² Ibid.

¹⁵³ Joubert and Calitz op cit (n106) 914.

¹⁵⁴ Finch op cit (n16) 380.

¹⁵⁵ Finch op cit (n16) 379.

¹⁵⁶ Finch op cit (n16) 381.

an inferior and passive role at the strategic level. Thus a diverging interpretation between management and the practitioner can result in a misapprehension between them.

The difficulty is compounded if information is required from a larger circle of actors.¹⁵⁷ Too much information from too many parties can lead to confusion and important records being ignored whilst less relevant documentary evidence is given undue consideration. Another intricacy associated with the unsound flow of data, occurs when there is a wide and diverse range of interests to be taken into account and each protagonist, who has a specific incentive and objective in trying to restructure the business, will be tempted to provide their own input accordingly.¹⁵⁸ This unwarranted concern is amplified when these different parties project the materials in a way to entice the specialist to comprehend information in a manner which is beneficial to their interests.

With different priorities from various parties, it is anticipated that there will be clashes and distortions which will affect the exchange of information. Consequently the resulting communication difficulties will affect the ability and commitment of management and the practitioner to co-operate amongst themselves in order to reach to a proper outcome.¹⁵⁹ Collaboration between the two parties can be facilitated by discussing about the probable intentions of the various parties from which information have been obtained so as to avoid any misconceptions which could have hindered the flow of information generating from directors¹⁶⁰ resulting in a potentially effective rescue regime.¹⁶¹

3.2 Divergence in priorities

To rehabilitate the financial situation of the distressed entity, the Act expects the practitioner to prioritise the benefits of creditors or shareholders by maximising their returns as provided by Section 128(1)(b)(iii) of the Act. Respectively, the practitioner will perceive that protection of corporate assets should be one of the priorities. As discussed earlier, in the event rescue proceedings are initiated by an affected party, the appointment of practitioner is

¹⁵⁷ Ibid.

¹⁵⁸ Finch op cit (n16) 380.

¹⁵⁹ Finch op cit (n16)382.

¹⁶⁰ Finch op cit (n16) 381.

¹⁶¹ Finch op cit (n16) 379.

determined significantly by the approval of creditors. In this line of reasoning, the practitioner is more likely to promote the interests of creditors. It is further to be noted that the section mentions to prioritise the interests of either creditors or shareholders, but not both of them. Thus there is no guarantee that the wishes of the owners of the company will be considered since they are not involved in the appointment process. It can be argued that since directors are employed with the main duty of promoting the interests of the company through the protection of the shareholders benefits, they can be annoyed if the creditors are given preference by the practitioner. It can be argued that management can retaliate by way of arguments or pressure of not collaborating unless the rights of the shareholders are safeguarded.

It can be submitted that there is no assurance that the interests of the creditors will be protected if the interests of the shareholders are prioritised. But as per the section 7(k) of the Act, the efficient rescue and recovery of financially troubled business should be undertaken in a way which balances the rights and wishes of all relevant affected parties.¹⁶² Thus, it might be argued that even though there is no express specified duty which has been imposed on the practitioner to adopt a stakeholder inclusive approach, it is implicitly understood that he is required to consider the well-being of other stakeholders, including that of creditors.

On the other hand, according to section 7(b)(iii) of the Act directors should endeavour to protect the welfare of the company together with taking into consideration the interests of other affected groups of people. In the same line goes the principles of the King Code III¹⁶³ which recommend management to take a stakeholder inclusive approach. Respectively, one of the parties to whom management owes a duty is the creditors. It has been commented that directors owe a fiduciary duty to creditors only when the business is on the verge of insolvency.¹⁶⁴ Given that management has to ensure that the interests of all affected group of stakeholders are protected irrespective of the corporate financial health as per the King Code and the Act, it implicitly means that the views and rights of creditors should be safeguarded anytime during the lifetime of the business.¹⁶⁵ Thus if the practitioner ignores the interests of the creditors, the board of directors may find it difficult to abide by the duty to promote the interests of this

¹⁶² Rushworth op cit (n3) 376.

¹⁶³ Institute of Directors op cit (n41), recommendation 1.1.9.

¹⁶⁴ McLennan op cit (n102) 132.

¹⁶⁵ Ibid.

particular stakeholder group since its' actions are subject to the approval of the practitioner. The directors failing to perform their duties correctly due to the practitioner, might be induced to be uncooperative.

Under the threat of penalisation by the monitoring authority, administrators are reluctant to make use of their discretion when making decisions.¹⁶⁶ Appropriate judgement made by the practitioner by using his acquired bankruptcy skills would benefit all relevant stakeholders.¹⁶⁷ Not making use of this prerogative will defeat the purpose of appointing an expert having the insolvency skills which management does not possess.¹⁶⁸ The practitioner being hesitant to use his discretion to take prompt measures can lead to an inefficient rescue regime.¹⁶⁹ It has been submitted that the returns of creditors are maximised when there is undue delay in taking decisions.¹⁷⁰ The quicker the response and remedial measures are taken to rehabilitate the distressed entity, the quicker the recovery will be.¹⁷¹ It must be noted that delay can reduce the value of the company's assets which is left for the distribution to creditors.¹⁷² As the directors are the one having all the information and know-how readily available, conveniently, they should be significantly involved in the policy making process to save the business from going bankrupt by taking quick and appropriate decisions.¹⁷³ But if the practitioner does not permit the managers to have an active role in the process, there is a risk that the corporate reorganisation will end up unsuccessful.

Nonetheless it was refuted that by leaving the entire corporate management to directors during insolvency would tempt them to continue to use their discretion to devise perilous tactics which can prove to be unfavorable to the owners of the company.¹⁷⁴ Shareholders customarily do not need a report of decisions taken on a daily basis but only expect the

¹⁶⁶ S Wheeler 'Directors' disqualification: insolvency practitioners and the decision-making process' (1995) 15 *Legal Studies* 283 at 301.

¹⁶⁷ Ibid.

¹⁶⁸ Ibid.

¹⁶⁹ Finch op cit (n16) 391.

¹⁷⁰ Ibid.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Ibid.

¹⁷⁴ G McCornack 'Control and Corporate Rescue: An Anglo American Evaluation' (2007) 56 *International and Comparative Law Quarterly* 515 at 524.

directors to use their expertise to maximise their return on investment.¹⁷⁵ By taking risky decisions, the managers will not be the one at a loss but may in fact even gain by speculative investment of the business' assets.¹⁷⁶ Moreover, with the managers left in control, they may attempt to do take any measures to preserve their jobs during the rescue regime¹⁷⁷ which might not automatically be in the interests of the shareholders and the other stakeholders. It can be said that maintaining the wide scope of prerogatives of directors can incentivise them to act in without due care again since they can easily seek refuge under the discretionary powers.¹⁷⁸ Thus, with the practitioner who has the faculty of curtailing any abuse of powers of management, directors will be hesitant to make inappropriate discretionary use of their privileges.

3.3 Too many actors' points of view

Business rescue proceedings normally entail multi-actors processes involving the collection of data, and the formulation and implementation of strategies which most probably will run serious risks of confusions, delays and uncertainties during the period. This section will elaborate on the various protagonists involved in the restructuration process.

Due appreciation should be given to acknowledge that the management may have personal motives for controlling the flow of data during the proceedings, as mentioned above. It might be contended that directors while trying to keep their job, will be tempted to present only positive information or to window dress the data so as to influence the practitioner in a manner which will be advantageous to them.¹⁷⁹ Directors can have recourse to the manipulation of certain accounting valuations which are based on variables and contingent events; and thus there is no guarantee that the amounts reflected in the records provided to the practitioner are correct and accurate.¹⁸⁰ Management might even consider maintaining uncertainty with regards

¹⁷⁵ AD Shaffer 'Corporate Fiduciary - Insolvent: The Fiduciary Relationship Your Corporate Law Professor (Should Have) Warned You About' (2000) 8 *American Bankruptcy Institute Law Review* 479 at 489.

¹⁷⁶ McCornack op cit (n174) 524.

¹⁷⁷ McCornack op cit (n174) 529.

¹⁷⁸ McCornack op cit (n174) 524.

¹⁷⁹ Finch op cit (n16) 380.

¹⁸⁰ Rushworth op cit (n3) 377.

to the business financial situation upon which the administrator will delay the decision making process.¹⁸¹

During the proceedings, the directors might be unsure about the intention of the practitioner by believing that the latter will be motivated to keep significant creditors such as banks happy rather than pursuing the corporate rescue. This sentiment is backed by the perception that the administrators will be employed recurrently in the insolvency field and since banks are the major providers of finance, they will have a say and significant influence on the choice of practitioner to be appointed.¹⁸² To ensure their employment, practitioners will endeavour to maintain a cordial rapport with the institutional banks.¹⁸³ Therefore there may be doubts that the practitioner being induced to keep banks satisfied instead of focusing on the restructuration of the company.¹⁸⁴

Banks play an important role in the rescue of distressed companies since the plans which the administrator intends to propose will be based on strategies which will require so called post-commencement finance.¹⁸⁵ In exchange of financial assistance to fund restructuring projects, these prospective fund providers will only be agreeable¹⁸⁶ to help by exercising their powers to impose terms and conditions on financing by restricting rearranged borrowing agreements, the operating activities, new investments, sale of assets, disbursements to shareholders, financial activities and the benchmark of accounting ratios which should be met by the corporation.¹⁸⁷ The attention of the practitioner will tend to be geared towards meeting these targets so as to obtain finance which may make the directors conceive that the practitioner's focus on the reorganisation priorities will be significantly compromised. Consequently, management might be reluctant to help the practitioner.

In another viewpoint, in order to have a detailed comprehension on nearly all aspects of the company and its business, the practitioner will tend to reach out to independent sources of

¹⁸¹ Finch op cit (n16) 380.

¹⁸² Finch op cit (n16) 381.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

¹⁸⁵ Ibid.

¹⁸⁶ Ibid.

¹⁸⁷ Finch op cit (n16) 389.

information such as banks which possess valuable data.¹⁸⁸ The banks are likely to provide a significant amount of stored data regarding the financial and operational aspect of the corporation.¹⁸⁹ There is a risk that these institutional lenders might influence the information by providing tactical data to the practitioner to promote their interests rather than that of other creditors of the company.¹⁹⁰ It can be debated that banks may be motivated to manipulate evidence to demonstrate an impractical rescue option¹⁹¹ whereby their help would be indispensable.

On a shareholder perspective, there is huge pressure from the owners of the company to remove the directors from the company if the officers do not promote their interests during the time when the entity is in a financially distressed position, which indirectly influences the free movement of information towards the practitioner.¹⁹² In cases where there is concentration of shareholders, it is more likely that they manipulate the directors to have their way out at the cost of the interests of creditors not being properly represented.¹⁹³ Therefore for the rights of creditors to be protected, it is in their interests to dismiss the directors from the management in financially troubled times.¹⁹⁴ In a polarised situation where there is a diluted shareholding, there is a clear separation between owners and management; subsequently the wishes of creditors are more concrete and ascertainable.¹⁹⁵ Even if there is pressure from shareholders, directors can easily opt out of the pressure and liaise with creditors in planning a reasonable rehabilitation regime.¹⁹⁶ It can be concluded that the greater the concentrated shareholdings, the greater will be the tendency for the owners of the entity to manipulate.¹⁹⁷ On the other hand, in a practitioner in control system, less influence will be expected by shareholders since the practitioner does not owe a specific compulsory duty to this particular group of investors.¹⁹⁸

¹⁸⁸ Finch op cit (n16) 383.

¹⁸⁹ Ibid.

¹⁹⁰ Ibid.

¹⁹¹ Ibid.

¹⁹² Finch op cit (n16) 380.

¹⁹³ McCornack op cit (n174) 541.

¹⁹⁴ Ibid.

¹⁹⁵ Ibid.

¹⁹⁶ Ibid.

¹⁹⁷ Finch op cit (n16) 389.

¹⁹⁸ Ibid.

3.4 Different expertise and formation

The UNCITRAL¹⁹⁹ guide on the qualifications of practitioners specifies that the difficulty involved in dealing with various insolvency proceedings requires the practitioner to have a diversified legal, commercial and accounting knowledge combined with sufficient experience in such areas.²⁰⁰ The Act²⁰¹ additionally dictates that the practitioner should have sufficient resources in terms of human and operational resources.²⁰² Generally, a practitioner is also required to have some skills in restructuring policies, management, advertising and merchandise expansion.²⁰³ But it is vital that the insolvency expert has a minimum professional qualification to aid him to undertake the task of corporate reorganisation and make appropriate value judgements.²⁰⁴ In the furtherance of the outlook, as per section 138(2)(b), it is a requisite that the practitioner encourages sound principles and good practice of corporate turnaround.²⁰⁵

Given the frequency with which the practitioner will be faced with different kind of corporate reorganisations, he might not be sufficiently equipped and at ease with various fields of expertise. Undoubtedly he will have the requisite skills and expertise in insolvency matters but he will not have an in-depth understanding of certain specific areas unrelated to his capabilities.²⁰⁶ Hence in such circumstances the insolvency professional will have recourse to the competency of other specialists on areas where he requires assistance.²⁰⁷

The fees paid for the advice of a turnaround specialist on a particular matter can be expensive; and an additional cost can aggravate the liquidity position of a company which is already in a troubled situation.²⁰⁸ Given that the practitioner cannot delay in placing the company back on the normal rail, the competent professional who has been appointed to give advice on the specific matter may be pressurised to give a finalised recommendation in a short

¹⁹⁹ UNCITRAL Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law (1997).

²⁰⁰ DA Burdette 'Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 2)' (2004) 16 *South African Mercantile Law Journal* 409 at 431.

²⁰¹ Section 138(2)(c).

²⁰² Rushworth op cit (n3) 390.

²⁰³ Finch op cit (n16) 385.

²⁰⁴ Burdette op cit (n200) 431.

²⁰⁵ Rushworth op cit (n3) 390.

²⁰⁶ Finch op cit (n16) 385.

²⁰⁷ Ibid.

²⁰⁸ Finch op cit (n16) 386.

span of time.²⁰⁹ The expert's judgement can be compromised since he has less time to give due consideration to critical elements and might even ignore crucial factors.²¹⁰ After reliance has been made on the expert opinion upon which proposals have been made, there is the possibility that creditors do not opt for those strategies but rather select those schemes which are most favourable to them and were based solely on the practitioner's expertise.

Regarding human resource or operational sphere, management is the most appropriate party to reach out to as it is better informed of the internal affairs with information obtained through board meetings.²¹¹ As such, those in charged with corporate governance, possess far greater relevant knowledge and data about the corporation than the practitioner.²¹² If management starts to anticipate an insolvent situation, they should duly continue to trade under these circumstances by keeping in mind the legal consequences.²¹³ If they are not permitted to undertake the dealing, they should advise the practitioner to carry out the transactions by providing justifications. Nonetheless it might happen that the practitioner is reluctant to act accordingly, which can affect the rescue regime and give rise to conflict between him and management.

It has been argued that directors should not be treated in a different way from other specialists like doctors, lawyers or bankruptcy specialists because their decision making process is almost alike.²¹⁴ But there are intrinsic differences which make the role of the directors distinctive from other professionals.²¹⁵ Firstly, other specialists have to undergo thorough broad academic preparation after which they need to undertake a period of practical training to ascribe the hierarchy to become an expert.²¹⁶ In contrast, directors usually acquire tertiary education but once they have been appointed to form part of the top management, they should endeavor to comprehend and acquaint to the company's philosophy, culture and activities by themselves.²¹⁷ Other professionals act in an environment where variables do not

²⁰⁹ Ibid.

²¹⁰ Ibid.

²¹¹ Finch op cit (n16) 385.

²¹² Ibid.

²¹³ Rochman op cit (n15) 51.

²¹⁴ Greenhow op cit (n148) 56.

²¹⁵ Ibid.

²¹⁶ Ibid.

²¹⁷ Ibid.

change much and a code of behaviour need to be followed to a certain degree where applicable.²¹⁸ On the other hand, management functions in a dynamic and volatile atmosphere, where factors such as economic conditions are beyond its control.²¹⁹ In case of fault on the part of the specialist, his service terminates and he can be sued under delict for failure to perform properly;²²⁰ whilst even if the directors underperform, they will remain the company's consultant except if there is a serious reason for them to be removed from office or to resign.²²¹ Even if the directors continue to form part of management despite their directorial fault, it does not preclude them from being personally held liable for their breach of duties.

With different background and expertise, it is very likely that the practitioner and the executive officers will have departing value judgements which can be anticipated to cause frictions and distortions affecting communication.²²² Also information substantiated from experts having different background and judgement, can affect the planning and execution of strategies difficult with risks of misunderstandings, reservations and postponements arising during the period.²²³ It thus can be deduced that despite encouraging the input of information from diverse officers, there may be too much data will result in misinterpretation of evidence reinforcing diverging points of view instead of having a common ground on how the company should be reorganised.²²⁴

3.5 Two different authorities

Appointing a practitioner to manage the business gives the assurance of independence to third parties.²²⁵ By substituting management's role, the insolvency expert is required to carry out the bulk of the functions of the directors.²²⁶ The rationale behind having an administrator to

²¹⁸ Ibid.

²¹⁹ Ibid.

²²⁰ Greenhow op cit (n148) 57.

²²¹ Ibid.

²²² Finch op cit (n16) 382.

²²³ Ibid.

²²⁴ Ibid.

²²⁵ McCornack op cit (n174) 523.

²²⁶ Bradstreet op cite (n4) 200.

oversee the company's affairs and to supervise the managers' functions to make sure that the practitioner acts as "whistleblowers" on unfit directors.²²⁷

The more powers are being conferred to the practitioner during the rescue regime, the more measures should be put in place to curtail abuse of these prerogatives.²²⁸ With a wide scope of powers and full corporate control allocated to the practitioner, it is understood that he forms the sole formal authority. Alongside it can be appreciated that his dominance can be curtailed by management who has a subdued authority through arrangements for consultation and negotiation undertaken between the two parties. As a result, discussion encourages potential benefits in openness and accountability and it may improve fairness in the restructuration of the entity.

However, the danger in a multiple authority decision making scenario is that differing opinions are exchanged which despite enhancing constructive discussion, can lead to a risk of potential deadlock.²²⁹ This can lead to compromise in the adoption of strategies where policies opted for, might benefit only a smaller number of stakeholders (such as creditors and shareholders) instead of equilibrating the interests of all affected parties (including the environment and the public in general).

It can be submitted that if the rescue procedures have not been initiated by the board of directors, they will not have a say in the appointment of the practitioner. Subsequently there is a possibility that the directors do not get along well with the practitioner or that the latter is not willing to heed what the management has to say. Moreover, it is statutorily provided by Chapter 6 of the Act that during the corporate rehabilitation process, the bankruptcy professional is entitled to dismiss any persons who formed part of the previous or current directorship from office.²³⁰ If the directors do not maintain a friendly relationship with the practitioner, they can be removed from the company. The managers will tend to compromise on what the practitioner says even if he is wrong, which can negatively affect the outcome of

²²⁷ D Milman 'Personal Liability and Disqualification of Company Directors: Something Old, Something New' (1992) 43 *Northern Ireland Legal Quarterly* 1 at 13.

²²⁸ Bradstreet op cit (n4) 209.

²²⁹ Finch op cit (n16) 385.

²³⁰ Bradstreet op cit (n4) 200.

the rescue proceedings. All these factors lead to more reservation on the part of management to team up freely with the insolvency practitioner.

Where the practitioner exercises his discretionary prerogatives reservedly and allow management to do its' job as it was before the rescue proceedings, he has more chances to have the cooperation of the directors which would help him to attain his objectives and targets.²³¹ However in the case of a defective management, such a collaboration would not be of much help; and only a very skilled and experienced practitioner would be able to revive the company from its' financial difficulties.²³²

3.6 Directors being blamed, no matter what

A notion has been developed recently stating that to let the directors stay in charge of the management of the business could be compared as leaving a drunkard in charge of a pub²³³ since they brought disgrace to the company.²³⁴ It has been commented that if a company is financially troubled, it is presumed that the directors failed to undertake their role as expected.²³⁵ Therefore they should no longer be entrusted the corporate control since they are the culprits for the insolvency.²³⁶ More modern perspectives of insolvency law not only advocate for the penalisation of management but also promote the allocation of time to the distressed company to prepare itself well before it faces the public humiliation and its' repercussions.²³⁷

South African law (based on the UK legal system) is reluctant to trust the skill and judgment of the existing managers. The regulatory framework does not welcome the thought of treating corporate difficulties as problems that need attention, but rather prefers to blame those charged with corporate governance for the business failure.²³⁸ This is why to ensure that management does not worsen the solvency position of the company, the provisions of the

²³¹ Bradstreet op cit (n4) 209.

²³² Ibid.

²³³ McCornack op cit (n174) 522.

²³⁴ Ibid.

²³⁵ Ibid.

²³⁶ Ibid.

²³⁷ Kloppers op cit (n8) 418.

²³⁸ Finch op cit (n16) 387.

section 137(2)(a) stipulate that although the directors of the company are not automatically removed from office during the proceedings, the scope of their duties is limited by the authorisation of the practitioner.²³⁹

It is persuaded that when risk takers are wrong, they should be reprimanded and the management should be handed to a practitioner who has the requisite expertise.²⁴⁰ Conversely, there is the view that if there is a risk averse corporate culture, directors will be less motivated to perform well by taking risk for fear that they will be dismissed or for not receive bonuses if they resigned too late in the event the business experiences financial difficulties.²⁴¹ But the general rule is that the more risks are taken, the greater are the returns. In this respect it might be said that the interests of shareholders are better protected if control stays in the hands of management.

In financial difficulty, the directors are better acquainted with the company's operations, they are thus more at ease to make better value judgement decision with regards to the rehabilitation.²⁴² The top level executives are accustomed to take risks when faced with uncertainties and if the standard of care is set too high, their judgement can be influenced adversely.²⁴³ It should be highlighted that it is not proper to always blame them for corporate failure in case the entity starts to experience troubling situations due to external factors in spite of impeccable managerial capability.²⁴⁴ Generally the judiciary is not too keen to interfere with internal company matters and is reluctant to judge the actions of management severely.²⁴⁵

It has been felt in the United States that instead of imposing harsh penalties, the provision of incentives to restructure businesses would encourage more companies to be set up which would result in job creation.²⁴⁶ Therefore it is not judicious to punish the management heavily,

²³⁹ Loubser op cit (n37) 502.

²⁴⁰ McCornack op cit (n174) 522.

²⁴¹ Bradstreet op cit (n4) 200.

²⁴² Finch op cit (n16) 387.

²⁴³ Du Plessis op cit (n104) 274.

²⁴⁴ Finch op cit (n16) 387.

²⁴⁵ Du Plessis op cit (n104) 274.

²⁴⁶ Loubser op cit (n11) 153.

except in cases of non-performance, gross negligence or trading recklessly, where they should continue to participate in the activities of the company under the supervision of a practitioner.

4. Chapter 3: Comparative Study

Chapter 3 will cover the statutory provision of each respective jurisdiction, namely Australia, United Kingdom and United States with respect to managerial duties and powers of practitioners and directors during the time a company is placed under business rescue coupled with the insolvent trading provisions. These countries have been chosen for comparisons because of the following reasons: Australia because it has a very similar rescue provisions to South Africa; the South African corporate legal systems was significantly derived from English law in United Kingdom; and as for the United States, the Chapter 6 of the South African Companies Act is loosely based on the American provisions laid out in Chapter 11 of the Bankruptcy Code.

4.1 Australia

Despite being sports rivals, the legal systems of Australia and South Africa are both considerably founded on the English law²⁴⁷ and both countries have inherited a Commonwealth legacy.²⁴⁸ Having the same source of law, it would be wise to make an analysis of the Australian insolvency law. The relevant statutory provision is Part 5.3A of the Corporations Act 2001²⁴⁹ (hereafter ‘Corporations Act’) which caters for the administration of a company’s affairs with a view of executing a deed of company arrangement. The document usually dictates the future behaviour of the business which will aid to restore the company’s financial situation.²⁵⁰ Once a rescue plan has been approved by the creditors, the terms of the arrangement become binding on them, the entity and its owners.²⁵¹

The implication of such kind of arrangements is the loss of control from the management and the creditors have more importance.²⁵² In this type of scheme, the interests of creditors are

²⁴⁷ C Anderson ‘Viewing the Proposed South African Business Rescue Provisions from an Australian Perspective’ (2008) 11 *Potchefstroom Electronic Law Journal* 1 at 2.

²⁴⁸ Kloppers op cit (n8) 420.

²⁴⁹ Corporations Act 2001 No. 50, 2001

²⁵⁰ Kloppers op cit (n8) 422.

²⁵¹ Ibid.

²⁵² Farrar op cit (n97) 107.

better,²⁵³ particularly as the procedure instructs that an appointed committee of creditors will have the supervision of the administration until the deed is executed by the business.²⁵⁴

4.1.1 Requirement to appoint a practitioner during business rescue

Similarly to South Africa, the administration proceedings can be initiated by board of directors' resolution²⁵⁵ or by a secured creditor.²⁵⁶ When the financially troubled company has recourse to the business rescue procedure termed as voluntary administration, an external administrator (which has similar role to the practitioner) is appointed.²⁵⁷ The appointment of the administrator is undertaken by the deed of company agreement.²⁵⁸ Upon employment, the administrator is required to take over the management of the business up to the time the deed becomes effective, after which he will have to follow the terms of his duties as stipulated into the agreement.²⁵⁹ The administrator is entitled to any performance or prerogatives that the company or any of its officers could exercise on a daily basis.

4.1.1.1 Duties of practitioner

When the business goes into voluntary administration, according to section 437A(1) of the Corporations Act, the control of the business is entrusted in the hands of the administrator who will manage the affairs with the aim of developing a deed of company arrangement.²⁶⁰ As provided by the section 435A of the Corporations Act, the objective behind this arrangement is that there is an increased possibility that the corporate foreseeable future will continue, which will have the potential effect that there will be a better return for both the creditors and members instead from what would have resulted from an immediate liquidation.

Division 4 of Part 5.3A of the Corporations Act imposes a duty on the administrator to inquire into the company's affairs.²⁶¹ He is required to inform the creditors at the meeting about

²⁵³ Ibid.

²⁵⁴ Kloppers op cit (n8) 422.

²⁵⁵ Section 436A of the Corporations Act.

²⁵⁶ Section 436B of the Corporations Act.

²⁵⁷ Australian Securities & Investments Commission 'Creditors – Voluntary Administration' available at <http://asic.gov.au/regulatory-resources/insolvency/insolvency-for-creditors/creditors-voluntary-administration/>, accessed on 14 March 2016.

²⁵⁸ Kloppers op cit (n8) 423.

²⁵⁹ Ibid.

²⁶⁰ Farrar op cit (n97) 107.

²⁶¹ Section 438A of the Corporations Act.

the outcomes of the various courses of action. It is further provided that he should report to regulatory authorities in case of infringement of the Corporations Act by the business.²⁶² In the event, the administrator and the directors are too much at ease with each other, the regulatory authority Australian Securities and Investments Commission (hereafter ‘ASIC’) and the creditors have powers to apply to the Court to put an end to the administration or to protect their interests in accordance with sections 447A and B of the Corporations Act.²⁶³ The aggrieved parties can also make an application to the court to request for matters decided by the administrator to be reviewed according to the section 447E of the Corporations Act.

4.1.1.2 Powers of Practitioners

During the voluntary administration period, the administrator is given effective corporate control which includes the appointment, suspension or removal of directors and other officers. In fact it is stipulated by the section 442A of the Corporations Act provision that the administrator is entitled to remove officers forming part of the management and to appoint substitutes to fill in the vacant position.²⁶⁴ The administrator can exercise any powers or discharge any duty which was carried out by the officers before the rescue regime.²⁶⁵ Along with the execution of documents on behalf of the company, the administrator should undertake in good faith any action which is necessary.

It may be noted that the privileges of the administrator are limited to the extent the creditors decide on the fate of the company and their willingness to use their discretion to restrict or extend the entitlements. It stands to reason that the range of powers will be determined through the creditors’ evaluation of the professionalism and ethical commitment of the practitioner.²⁶⁶ Any powers given through a deed of company arrangement will have to be respected according to the terms and conditions incorporated in the document.²⁶⁷

²⁶² Anderson op cit (n247) 23.

²⁶³ Farrar op cit (n97) 107.

²⁶⁴ Ibid.

²⁶⁵ Kloppers op cit (n8) 422.

²⁶⁶ Farrar op cit (n97) 107.

²⁶⁷ Anderson op cit (n247) 23.

4.1.2 Role of directors

Primarily the directors are required to assist the administrator but their roles are subject to changes depending on the terms set out in the deed of company arrangement.

4.1.2.1 Duties of directors

It is compulsory for directors to help the administrator by providing all relevant documentation and advice about the whereabouts of the records. Another duty imposed on them is that they should frequently meet and respond to the respective queries of the practitioner as far as these are reasonably feasible and in their capacity.²⁶⁸

The directors are required to discharge their duty with care, skill and diligence as per the Section 232(4) of the Corporations Act. The standard of the duty that the officers should exercise is the demeanour of any reasonable individual having the same qualifications and is in a likewise corporate post as the directors, with respect to the circumstances of the entity.²⁶⁹ It should be noted that the explicit provisions in regard to insolvent trading is ‘an important subset of the duty of care’.²⁷⁰

Additionally in Australia, the duties of directors are incorporated in the statutory business judgment rule as per section 180(1) of the stated law whereby some conditions have to be met so as the management can be immuned from liability to management for gross negligence.²⁷¹ In order to have recourse to the rule, the directors should have had made ‘business judgements in good faith and for a proper purpose, have acted on an informed basis without material personal interest and have were rationally convinced that the decision taken is in the best interests of the corporation’.²⁷² If any one of these elements has not been met, remedy under the principle cannot be sought.²⁷³ It is to be pointed out that the rule does not extend to the situations where

²⁶⁸ Australian Securities & Investments Commission ‘Directors – Role assisting external administrator’ available at <http://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/directors-role-assisting-external-administrator/>, accessed on 14 March 2016.

²⁶⁹ Farrar op cit (n141) 750.

²⁷⁰ Farrar op cit (n141) 754.

²⁷¹ Farrar op cit (n141) 746.

²⁷² Greenhow op cit (n148) 33.

²⁷³ Ibid.

management has abandoned its responsibility and has failed to make use of sound judgement in the decision making process.²⁷⁴

4.1.2.2 Powers of directors

There is no law which gives shareholders or ordinary creditors the right to influence the appointment of an administrator. Further there is no provision that gives the court the power to issue make an order with respect to the appointment of the administrator. It makes sense that in the absence of provisions in that regard, it is the board which has the control of the appointment.²⁷⁵

As per section 437C(2) of the Corporations Act, during administration period, directors are not dismissed but their powers can be frozen.²⁷⁶ Hence, they can only act when said and action has been authorised by the administrator.²⁷⁷ However, if they act without such authority, the act is void and they can be prosecuted for an offence under the section 437D(5) of the Act and may be liable for compensation.²⁷⁸ Nonetheless the powers of the directors may again become effective partly or wholly subject to a deed of company arrangement. It can be appreciated that the terms set out in the deed regarding the powers of the managers will depend largely on the creditors' opinion on the conduct of directors prior to the administration.²⁷⁹

4.1.3 Insolvent trading

Section 588G of Corporations Act provides for insolvent trading which prescribes a positive duty imposed on management to guarantee that no further debts are incurred when the company is or will be likely to be insolvent subsequent to the incurrence of the debt. It is necessary that there are reasonable grounds for suspecting the insolvency of the company when additional financing liability is incurred.²⁸⁰ Generally the standard of the suspicion should be that any reasonable person in the same position in a business, experiencing the same company's

²⁷⁴ Greenhow op cit (n148) 39.

²⁷⁵ Anderson op cit (n247) 8.

²⁷⁶ Farrar op cit (n97) 107.

²⁷⁷ Ibid.

²⁷⁸ Section 437E(1) of the Corporations Act.

²⁷⁹ Farrar op cit (n97) 107.

²⁸⁰ H Anderson 'Directors' Liability For Corporate Faults And Defaults - An International Comparison' (2009) 18 *Pacific Rim Law & Policy Journal* 1 at 22 – 23.

circumstances, should have the same doubt.²⁸¹ It has been advocated that the objective of the insolvent trading provisions is to safeguard that directors stops ceases trading as soon as possible when it is justifiably presumed that the business cannot trade its way out of financial difficulties.²⁸²

4.1.3.1 Penalties

Contravening the Section 588G(2) of the Corporations Act on insolvent trading will result in various prospects of penalisation such as ‘civil penalty under Part 9.4B’.²⁸³ If the fraudulent determination, as one of the core elements for the criminalisation of the act has been proved as per Section 588G(3), criminal proceedings initiated in accordance with section 1317P.²⁸⁴ Management can be prosecuted for criminal charges which can lead to either a fine of up to \$220,000, an imprisonment for up to a term of 5 years, or both.²⁸⁵ Usually, the burden of proof is on the aggrieved party who is seeking remedy.²⁸⁶ In a civil case the standard of proof will on a balance of probabilities whilst in a criminal proceeding, the standard will be beyond reasonable doubt.²⁸⁷

Another possibility of penalty being imposed is under Section 588M(1) which provides for compensation proceedings for amounts lost by creditors which can be initiated by ASIC, a liquidator or a creditor against a director personally, for which a compensation order can be made in addition to civil penalties.²⁸⁸ Compensation payments are potentially unlimited which could subsequently lead to the personal bankruptcy or disqualification of directors.²⁸⁹ It might also occur that their personal liability on guarantees is entailed or a notice can be sent, requiring them to be liable for unremitted tax deductions.²⁹⁰ The executive officers can further be subject to banning orders.²⁹¹

²⁸¹ HH Rajak ‘Director and Officer Liability in the Zone of Insolvency’ (2008) *Potchefstroom Electronic Law Journal* 11.

²⁸² Fourie op cit (n100) 157 at n43.

²⁸³ Farrar op cit (n97) 106.

²⁸⁴ Ibid.

²⁸⁵ Ibid

²⁸⁶ Farrar op cit (n97) 103.

²⁸⁷ Ibid.

²⁸⁸ Farrar op cit (n97) 106.

²⁸⁹ Australian Securities & Investments Commission ‘Directors – Consequences of Insolvent Trading’ available at <http://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/directors-consequences-of-insolvent-trading/>, accessed on 14 March 2016.

²⁹⁰ Farrar op cit (n97) 107.

²⁹¹ Anderson op cit (n280) 22 – 23.

4.1.3.2 Remedies

The Corporations Act provides some statutory defences for directors. However, directors may find it hard to seek these safe harbours if they have not taken measures to be always be informed about the company's financial position.²⁹² One of the shields set out in section 588H(2) of the Corporations Act is that the director needs to have reasonable justifications to prove that according to his judgement and assessment, he expected the business to be continuously solvent.²⁹³ Some other safeguards according to the sections 588H(4) and 588H(5) are respectively that the director did not participate in the management of the company at the time the debt was incurred for a good reason or that the officer took necessary measures to avoid that the business incurring the financing liability.²⁹⁴ The court also has the authority to excuse the director from liability if he has acted honestly and have met the criteria provided by the section 1317 and 1318.²⁹⁵

As stated earlier, directors are entitled to also seek redress under the business judgment rule which provides that directors must have had exercised their powers and carrying out their duties with the good faith, care and diligence of a reasonable person. Thus they need not have any intention of acquiring any material personal interest and should instead focus their judgment in the best interests of the corporation.²⁹⁶ It could be concluded that the directors will not be able to have recourse to the business judgment rule if they failed to take measures in averting insolvent trading as provided by the Section 180(2) of the Corporations Act.²⁹⁷

4.2 United Kingdom

The South African law is derived from the English law, as such it is important to analyse this comparable legal mechanism to attempt to probe into appropriate solutions. Respectively we will rely primarily on Enterprise Act 2002 (hereafter 'Enterprise Act') and Insolvency Act 1986 (hereafter 'Insolvency Act'). The Insolvency Act was based on the recommendation of

²⁹² Australian Securities & Investments Commission op cit(n260).

²⁹³ M Quinlan 'What is insolvent trading?' available at <http://www.findlaw.com.au/articles/782/what-is-insolvent-trading.aspx>, accessed on 14 March 2016.

²⁹⁴ Ibid.

²⁹⁵ Ibid.

²⁹⁶ R Purslowe 'Decision In The Twilight Zone Of Insolvency – Should Directors Be Afforded A New Safe Harbour?' (2011) 13 *University of Notre Dame Australia Law Review* 113 at 114.

²⁹⁷ Farrar op cit (n97) 102.

the Cork Committee which advanced that an efficient bankruptcy law should preserve the viability of companies to make a productive contribution to the economy of the society.²⁹⁸ Subsequently, the same approach has been adopted by the judiciary; and the Court observed that the law has ‘rescue-friendly’ provisions.²⁹⁹ British bankruptcy law is founded on the presumption that if the company becomes financially distressed, it is because of a gross mismanagement and therefore the directors should be de-possessed with executive responsibilities.³⁰⁰ Unlike the Schedule B1 of the Insolvency Act 1986 which empowers the administrator with wide powers, the South African Companies Act refrains from adopting such approach.³⁰¹

4.2.1 Requirement to appoint a practitioner during business rescue

The Enterprise Act was enacted as an attempt to inculcate a rescue culture by shifting control from the hands of the management into that of an independent insolvency professional referred as the administrator, which is the equivalent of the South African practitioner.³⁰² The administrator needs to be qualified to act as a bankruptcy specialist.³⁰³

4.2.1.1 Duties of practitioner

The Enterprise Act requires for an administration order to be obtained in accordance with the section 8(3) paragraph 3 of the new Schedule B1 of the Insolvency Act for the rescue proceedings to commence. The Enterprise Act states that the bankruptcy specialist shall firstly ensure the foreseeability of life of the troubled entity by maximising the value of the corporation.³⁰⁴ In the second position of the objective hierarchy, the administrator must perform his functions with the objective to achieve a better result for the creditors instead of the business being winding up.³⁰⁵ If the two of the aforementioned objectives cannot be met, the practitioner should ‘realise collateral for the benefit of secured and preferential creditors’.³⁰⁶ To meet the aims mentioned, an administrator is required to carry out his functions as soon as he is

²⁹⁸ J Armour, A Hsu and A Walters ‘Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002’ (2008) 5 *European Company and Financial Law Review* 148 at 149.

²⁹⁹ Ibid.

³⁰⁰ McCornack op cit (n174) 522.

³⁰¹ Cassim op cit (n2) 893.

³⁰² Finch op cit (n16) 374.

³⁰³ A Loubser ‘An International Perspective on the Regulation of Insolvency Practitioners’ (2007) 19 *South African Mercantile Law Journal* 123.

³⁰⁴ Armour, Hsu and Walters op cit (n298) 160.

³⁰⁵ Finch op cit (n16) at 395.

³⁰⁶ Armour, Hsu and Walters op cit (n298) 160.

appointed.³⁰⁷ However it should be noted that the Enterprise Act restricts the duration of the administration to a maximum 12 months;³⁰⁸ but an extension can be granted by the Court or by the creditors.³⁰⁹

Generally the practitioner will be appointed ‘by a secured creditor having security over the whole of the assets of the company’.³¹⁰ Although the creditors have significant influence over the employment of an administrator, the latter should not only focus on the benefits of the creditors.³¹¹ The administrator has also a duty towards the company and its shareholders as he is required to preserve the business of the entity.³¹² Any aggrieved party can apply to court in the event the practitioner did not consider or harmed his interests.³¹³ Consequently as defence, the administrator should justify how the rescue was better achieved by forgoing the interests of that particular stakeholder. Since it a subjective test to be applied, it is very likely there will be limited room for judicial review.³¹⁴

Whilst being entrusted with the management of the business, the administrator is required to carry out an investigation into the affairs of the entity and formulate a proposal to restore the financial position of the business.³¹⁵ The plans advanced by the administrator need the approval of a simple majority of the creditors for the strategies proposed to be executed.³¹⁶ By putting forward various proposals, the administrator is compelled to explain his choice and justify why a specific cause of action is more suitable rather than the others.³¹⁷

4.2.1.2 Powers of Practitioners

In United Kingdom, the practitioner acts as the company's agent³¹⁸ who is entitled to undertake any action or decision that is necessary for the normal operation of the business.³¹⁹

³⁰⁷ Ibid.

³⁰⁸ Cassim op cit (n2) 877.

³⁰⁹ Ibid.

³¹⁰ McCornack op cit (n174) at 515.

³¹¹ McCornack op cit (n174) 530.

³¹² Ibid.

³¹³ Schedule B 1 paragraph 74 of the Insolvency Act.

³¹⁴ McCornack op cit (n174) 530.

³¹⁵ Kloppers op cit (n8) 421.

³¹⁶ Ibid.

³¹⁷ McCornack op cit (n174) 530.

³¹⁸ Schedule B I paragraph 69 of the UK Insolvency Act.

³¹⁹ Schedule BI paragraph 59(1) of the UK Insolvency Act.

The prerogatives include the right to manage and dispose of assets.³²⁰ The administrator has the power to appoint or remove directors under the Insolvency Act.³²¹ In fact the wide entitlements of the practitioner mean that the expert should be accountable about his actions if he does not promote the benefits of creditors.³²² If he does not perform his duties well, his powers may be curtailed or snatched from him. The creditors have the capacity to have the administrator removed from office if he does not prioritise their wishes. The employment of the administrator can also cease subsequent to his own application to Court requesting for his discharge.³²³

4.2.2 Role of the directors

The directors still form part of management but have a secondary role comprising of assisting the administrator as and when required. They should apply the standard of care, diligence and skills when performing their duties.

4.2.2.1 Duties of directors

Directors should carry out their duties as prescribed by the sections 171 to 177 of the UK's Companies Act 2006 with respect to the duty of reasonable care and skill, obligation not to accept any benefits from third party, ensuring the success of the business, to make rational decisions, to prevent any risk of conflict of interest and if a director has any interest, he is required to make related disclosures.³²⁴ A specific duty imposed on the directors particularly during the bankruptcy situation is that from the time the corporation becomes insolvent, the management is required to prioritise the benefits and wishes of the creditors since they are the ones who are most affected by the loss in value of the corporation.³²⁵ In case the directors became aware that the financial situation is worsening, they should cease trading. If they continue to transact, they may be liable for the offence of wrongful trading or fraudulent dealing.

³²⁰ Armour, Hsu and Walters op cit (n298) 156.

³²¹ Finch op cit (n16) at 390.

³²² Armour, Hsu and Walters op cit (n298) 160.

³²³ Kloppers op cit (n8) 421.

³²⁴ A Edge and R Mulligan 'The International Comparative Legal Guide to: Corporate Governance 2009 – Directors' Duties in the "Zone of Insolvency"', available at https://www.ashurst.com/doc.aspx?id_Content=4603, accessed on 23 January 2016.

³²⁵ McCornack op cit (n174) 527.

The managers should also abide by the duties enumerated above as well endeavouring to promote the interest of the corporation, to utilize the assets of the entity only for the business' transactions, to respect and apply the principles laid in the constitution of the company and to prevent to make secret profit.³²⁶ The practitioner has a significant power to influence the performance of management where he is entitled to bring a claim for summary judgment on the behalf of the business to assert any infringement of duty owed by a director as per the section 212 of the Insolvency Act.

4.2.2.2 Powers of directors

Often when directors are considering to engage a practitioner, they will take into account if the administrator would be most probably accept their continued management of the business.³²⁷ As there is no express restriction that a practitioner cannot retain the assistance of the directors, the latter can still form part of the decision making process.³²⁸ Additionally, the powers of management are subject to the approval of the practitioner to the extent these privileges do not interfere with the functions of the administrator.³²⁹ Subsequently, the administrator may delegate some of his functions in the directors' hands but he cannot assign all of them so as to escape responsibilities.

4.2.3 Insolvent trading

In United Kingdom, the law caters for two offences which constitute insolvent trading. These legal violations are namely fraudulent trading and wrongful trading. It is worth noting that wrongful trading is more closely related to insolvent trading. By contrast to wrongful trading, fraudulent trading is a lesser offence.

Fraudulent trading is a criminal offence where the directors continue to carry out operations with the aim to defraud the creditors of the entity. It is defined as necessitating real deceitfulness with relation to the common practice of equitable trading by section 213 of the

³²⁶ G Cousins 'Your duties and responsibilities as a director', available at <http://www.businesswings.co.uk/articles/Your-duties-and-responsibilities-as-a-director>, accessed on 14 March January 2016.

³²⁷ Schedule B 1 paragraph 64 of the Insolvency Act.

³²⁸ McCornack op cit (n174) 527.

³²⁹ Paragraph 64(2)(a) of the Insolvency Act.

Insolvency Act.³³⁰ Thus the offence requires that there is a lesser intention of fraud by the directors although they have been acting in bad faith.³³¹ The court can order the directors to contribute the assets if the judicial institution determines that the officers were party to a transaction whereby the aim was to defraud creditors.³³²

The concept of wrongful trading was taken from the recommendation of the Cork Committee. The foundation of the principle is that any person who continues to trade despite knowing that the company is insolvent or is unable to meet its current expenses should be held liable.³³³ Section 214 of the Insolvency Act is considered to be a powerful instrument in changing the conduct of management in case there is a high risk that the business might fall into insolvency.³³⁴ The provision stipulates that wrongful trading is a situation whereby management continues to undertake business although it was aware that the entity might go into liquidation. Given that it is a civil offence, section 214 of the Insolvency Act requires that the mental intent of the director to undertake fraud should only be proved on a balance of probabilities.³³⁵

Liability only takes place upon insolvent liquidation and does not relate to the entire life of the business.³³⁶ In order to refute accusations of wrongful trading, directors should prove that they took all reasonable and necessary measure to curtail any loss or detrimental consequences once they took cognisance there is no possibility that the business can escape winding up.³³⁷ In order to be exempted from liability, a director should respect the standard and duties required to be exercised by any reasonable director having the same experience.

4.2.3.1 Penalties

The personal liability of directors can be pursued under the Company Directors Disqualification Act with respect to consistent breaches of the corporate law, corporate fraud,

³³⁰ Anderson op cit (n280) at 22-23.

³³¹ Rajak op cit (n281) at 18.

³³² Directors' duties and responsibilities' (2015), available at <http://www.iod.com/guidance/briefings/cgbis-directors-duties-and-responsibilities>, accessed on 14 March 2016.

³³³ A Campbell 'Wrongful Trading and Company Rescue' (1994) 25 *Cambrian Law Review* 69.

³³⁴ Campbell op cit (n333) 71.

³³⁵ J Girgis 'Corporate Directors' Disqualifications: The Canadian Regime?' (2009) 46 *Alta Law Review* 677.

³³⁶ V Finch 'Company Directors: Who Cares About Skill and Care?' (1992) 55 *Modern Law Review* 179 at 200.

³³⁷ Fourie op cit (n100) 153.

previous similar offences, unfitness and participation in wrongful or fraudulent trading.³³⁸ Moreover, under the section 993 of United Kingdom's Companies Act 2006, an offender of fraudulent trading is liable to a fine of up to £10,000 whilst there is a separate penalty for wrongful trading which is primarily of compensatory nature rather than penal.³³⁹

4.2.3.2 Remedies

There is no specific statutory provision for the business judgment rule in this jurisdiction but the principle has been adopted informally. The business judgment rule is founded on the assumption that the director took decision in good faith and by taking all relevant factors in consideration before making use of his judgement.³⁴⁰ The courts have customarily been reluctant to adjudicate on directors' business decisions where fraud or bad faith was not a factor.³⁴¹ The rule safeguards the decision of management which was taken rationally and in the best interest of the entity, instead of the replacing strategies through the verdict of the court.³⁴²

There is a defence set out at section 214(3) of the Insolvency Act which can exonerate the liability of directors if they are able to satisfy the Court that they took all appropriate measures to ensure that the potential loss to the creditors have been curtailed upon being informed that there is no reasonable prospect of the business to prevent liquidation.³⁴³

4.3 United States of America

This thesis adds the United States of America as a comparison because when South Africa was considering changing the business rescue procedures, the Department of Trade and Industry³⁴⁴ issued a documentary guideline stating that the reform would be based largely on the Chapter 11 of the American Bankruptcy Code 1978 (hereafter 'the Code').³⁴⁵ Although the South African insolvency system has a creditor friendly approach, the Act is influenced by the

³³⁸ DM Skene 'How insolvency works in Scotland' (2003) 11 *Juta's Business Law* 104.

³³⁹ Fourie op cit (n100) 155.

³⁴⁰ Girgis op cit (n335) 704.

³⁴¹ Ibid.

³⁴² Ibid.

³⁴³ Ibid.

³⁴⁴ South African Company Law for the 21st Century: Guidelines for Corporate Reform at 4, available at <http://www.thedti.gov.za/ccrd/companies/Guidelines04.pdf>, accessed on 14 March 2016.

³⁴⁵ A Loubser 'Tilting at windmills? The quest for an effective corporate rescue procedure in South Africa law' (2013) 4 *South African Mercantile Law Journal* 437.

Chapter 11 which focuses on a debtor friendly rescue proceedings.³⁴⁶ The American approach ‘encourages an early and timely resort’ to corporate restructuration ‘instead of postponing it until’ the entity starts to experience severe financial difficulties.³⁴⁷

In the United States, there is a culture which is ‘much more tolerant to lack of liquidity’.³⁴⁸ It was experienced in the country that less severe penalties would assist financially failed companies to recover, which will in turn incentivise more incorporation of companies leading to job creation.³⁴⁹ The reorganisation process described in Chapter 11, was initially designed to target small companies which has cash difficulties and required the observation of the court in order to revive the financial position.³⁵⁰ Therefore the Chapter has the main objective of aiding the rescheduling the business’ affairs until it financially recovers.³⁵¹ There is the presumption that the troubled business worth more through restructuring rather than by liquidating the entity.³⁵² Nonetheless, it is up to management to decide whether to initiate the reorganisation process or not and the regulation provides that for an effective corporate rehabilitation, it is vital for the Court to intervene.³⁵³ Normally, the rescue proceedings start with a voluntary filing of a petition by the distressed corporation.³⁵⁴

4.3.1 Requirement to appoint a practitioner

In the United States, there is no requirement to appoint a practitioner but some of the managerial decisions making processes can be influenced by the creditors’ committee whilst in other cases, the approval of the bankruptcy court might be required. Further, in exceptional cases, section 1104 of the Code provides that a trustee will be appointed by the United States Trustee or by the Court upon application by an affected party.³⁵⁵ The trustee will be employed

³⁴⁶ Cassim op cit (n2) 866.

³⁴⁷ Cassim op cit (n2) 878

³⁴⁸ Farrar op cit (n141) 746.

³⁴⁹ Loubser op cit (n11) 153.

³⁵⁰ Farrar op cit (n141) 746.

³⁵¹ WC Robinson ‘Entry Requirements: A Comparative Analysis of the Corporate Regimes in Australia, the United Kingdom and the United States of America’ (1995) 8 *Corporate & Business Law Journal* 129.

³⁵² McCornack op cit (n174) 517.

³⁵³ Ibid.

³⁵⁴ Ibid.

³⁵⁵ Loubser op cit (n303) 135.

to manage the business of the company³⁵⁶ but the oversight of the rescue process is undertaken by the Court.³⁵⁷

Where there has been fraudulent behaviour, failure to perform, significant mismanagement or suspicion of same and it is consequently in the interests of all important stakeholders to appoint a trustee,³⁵⁸ the officer of the State will be employed to substitute the directors of the entity after the commencement of a reorganisation but preceding the conclusion of a plan.³⁵⁹ The trustee should be adequately qualified, independent from the company and must not have any affinity with any person related to the company's management or to a direct stakeholder.³⁶⁰ In practice, 'most trustees are traditionally appointed from the ranks of attorneys'.³⁶¹

4.3.1.1 Duties of practitioner

In the American system, there is no practitioner but the system makes provision for trustees who are appointed by a court order, only in the event that management is dishonest and such an order would be in the interests of creditors.³⁶² The trustee will carry out any necessary performance required so that the liquidity position of the distressed entity is stabilised. His duty would include monitoring the progress of the proceedings and 'the compliance of reporting requirements'.³⁶³ The trustee can appoint members of official committees such as the committee of unsecured creditors.³⁶⁴ The trustee is entitled to hire experts such as lawyers, accountants amongst others. If the committee has been employed, it will be designated to monitor the operations of the business, consult on significant business strategies.³⁶⁵

³⁵⁶ LP Granfield, SA O'Neal and TSMehok 'International Insolvency and Bankruptcy' International Corporate Practice (2008) at 29-14, available at <http://www.cgsh.com/files/Publication/a0a16588-98fb-44b1-be6e-1144b38967c6/Presentation/PublicationAttachment/d36713eb-52ce-422d-86bd-12360d4ca284/Intl%20Insolvency-Bankruptcy%20Article.pdf>, last accessed on 14 March 2016.

³⁵⁷ D Botter, L Beckerman, RE Albanese, AGS Hauer and Feld LLP 'Restructuring and insolvency in the United States: overview', available at <http://us.practicallaw.com/7-501-6870?source=relatedcontent>, last accessed on 29 February 2016.

³⁵⁸ Ibid.

³⁵⁹ Armour, Hsu and Walters op cit (n298) 134.

³⁶⁰ Loubser op cit (n303) 135.

³⁶¹ Ibid.

³⁶² Ibid.

³⁶³ United States Courts 'Chapter 11 – Bankruptcy Basics' <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>, last accessed on 29 February 2016.

³⁶⁴ Botter, Beckerman, Albanese, Hauer and Feld LLP op cit (n357).

³⁶⁵ Ibid.

If a trustee has not been employed, the creditors committee will provide their views on the manner the entity should be restructured. The strategies set out in a reorganisation plan necessitate the approval of the majority of creditors and two-thirds in value of holdings of each category of creditors.³⁶⁶ Indirectly, it is the creditors' committee which has a strong influence on the way the company's restructuring should be undertaken since their interests should be protected.³⁶⁷ The best interests test protects dissenting creditors by supporting that each one of them who objects should obtain a minimum return which is equivalent to the amount the party would have received if the entity would wind up.³⁶⁸

4.3.1.2 Powers of practitioner

A creditors' committee is only allowed to advise the distressed company but the control stays in the hands of the management as suggested by the subsection 1103(c) of the Code. Under subsection 1103(c)(2) of the Code, the committee has the privilege of investigating into the company's affair which will ultimately help them in making an informed decision about the feasibility of a reorganisation plan.³⁶⁹ Creditors are entitled to propose restructuring plans only after a few months after the troubled company, through its' management has made such plans.³⁷⁰

If the committee appreciates management is unable to restructure the company properly, they may seek that a trustee be appointed pursuant to Code subsection 1103(c)(4) and Section 1104. The appointed supervisor or trustee can be considered to be a 'second-class administrator' with restricted prerogatives because they are entitled with only half of the salary allocated to administrators normally.³⁷¹

³⁶⁶ McCornack op cit (n174) 518.

³⁶⁷ PC Blain and DH O'Gawa 'Creditors' committees under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers and Duties' (1990) *Marquette Law Review* 580, available at <http://scholarship.law.marquette.edu/cgi/viewcontent.cgi?article=1745&context=mulr>, accessed on 14 March 2016.

³⁶⁸ McCornack op cit (n174) 518.

³⁶⁹ Ibid.

³⁷⁰ Ibid.

³⁷¹ McCornack op cit (n174) 523.

4.3.2 Role of directors

The directors still carry out the same duties and functions as before the company goes into the zone of insolvency since the management of the company is still placed in their hands. Under the insolvency legislation laws, dealings that fall outside of the scope of the company's ordinary course of business require the bankruptcy court approval beforehand, which implicitly equates to an additional layer of protection for the director.³⁷²

4.3.2.1 Duties of directors

The Chapter 11 provides that pre-insolvency managers of the company should stay in control subject to supervision by the Court,³⁷³ a scenario, referred to as debtor-in-possession (hereafter 'DIP'). This is a situation where the debtor company remains in control of its own business through its' directors. While continuing to run its business, the company, assisted by its advisors, works to develop a plan of restructuring from negotiations among the stakeholders.³⁷⁴ Management has the exclusive right to make proposals with regards to the plan for a period of 120 days, after which the creditors may do so.³⁷⁵ The court needs to approve the rescue plan³⁷⁶ which emphasise the importance for the distressed business to meet the commitments listed in the plan.³⁷⁷ During the period of DIP, the managers are entitled to the same powers as an appointed trustee would have, if he was employed.³⁷⁸

In general, the directors manage the corporation for the benefit of shareholders but when the business is insolvent, the absolute priority rule of Chapter 11 of the Code instructs that the focus should instead be diverted towards the safeguard of the interests of the creditors since the latter will bear the risk of loss in the value of the entity.³⁷⁹ This approach has long been adopted by the Court in the adjudication of cases.³⁸⁰ But there has been some judicial statements

³⁷² Greenhow op cit (n148) 46.

³⁷³ Farrar op cit (n97) at 107.

³⁷⁴ P Mindlin 'Comparative Analysis Of Chapter 6 Of The South African Companies Act, No. 71 Of 2008 (Business Rescue Proceedings)' (2013) for the Presentation to the Company Law Symposium organized by The South Africa Department of Trade and Industry & The Specialist Committee on Company Law Johannesburg, South Africa, available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf, accessed on 14 March 2016.

³⁷⁵ Cassim op cit (n2) 897.

³⁷⁶ Ibid.

³⁷⁷ Ibid.

³⁷⁸ Loubser op cit (n303) 135.

³⁷⁹ R Barondes 'Fiduciary Duties Of Officers and Directors Of Distressed Corporations' (1998-1999) 7 *George Mason Law Review* 45 at 63.

³⁸⁰ McCornack op cit (n174) 526.

arguing that during the insolvency period, the directors have a duty to stakeholders who sustain the business and they should take decisions in an informed good faith manner so as to optimise the entity's capacity to generate wealth in the long run.³⁸¹ Therefore the DIP places a duty on the managers to balance the interests of all relevant parties and resolve the conflicting tensions that arise between them.³⁸²

The directors should continue to apply the standard of the duty of reasonable diligence and care. As for the duty of care, it has been partly inspired by the law of delict.³⁸³ It is considered that the fiduciary duty of loyalty owed by the company should be treated as a default rule.³⁸⁴ If the directors have applied the standard as required, they may seek protection under the judgement rule.³⁸⁵ However it is vital that the executive officers cognise that all material information are readily be available to them before making a business decision.

The business judgement rule has been catered for by common law³⁸⁶ by way of case laws as there is no specific statute providing for the rule.³⁸⁷ Only the principles of the American Law Institute's Corporate Governance project stipulate for the doctrine.³⁸⁸ The judgement rule requires the officers to make calculated decisions relating to the business in good faith by being informed that it is correct to undertake such decisions in these particular circumstances. The directors should rationally believe that such decision will be in the best interest of the entity.³⁸⁹ Since the rule protects officers, even the appointed trustee can seek refuge under the rule.³⁹⁰ However if it has been proved that the officers did not take any precautionary measures, they will not be shielded from liability. Unlike the Australian and English approach, in the United

³⁸¹ McCornack op cit (n174) 527.

³⁸² American Bar Association 'Insolvency and fiduciary duties: Advising directors and officers when the company cannot pay its bill' (2010) available at <http://www.americanbar.org/content/dam/aba/publications/blt/2010/09/inside-buslaw-insolvency-201009.authcheckdam.pdf>, accessed on 14 January 2016.

³⁸³ Finch op cit (n336) 205.

³⁸⁴ Shaffer op cit (n175) 551.

³⁸⁵ Finch op cit (n336) 189.

³⁸⁶ Greenhow op cit (n148) 34.

³⁸⁷ Farrar op cit (n141) 761.

³⁸⁸ Ibid.

³⁸⁹ Greenhow op cit (n148) 51.

³⁹⁰ Greenhow op cit (n148) 40.

States, the criterion of taking a decision in good faith is implied and is not specifically expressed as a separate pre-condition.³⁹¹

4.3.2.2 Powers of Directors

One of the proposals put forward during the promulgation of the Code was that the company should still have corporate control so as to encourage management to have recourse to remedies provided by the Chapter 11; otherwise they will delay to solve the insolvency situation by relying to the appropriate statutory measures when there will be no longer prospects for reorganisation and it would be too late for a potentially effective rehabilitation.³⁹² In line with this theory, provisions regarding wrongful trading and directors' disqualification are foreign to the American law.³⁹³

As mentioned above, many of the managerial decisions are subject to the disclosure and consent of the bankruptcy court. It should also be highlighted that even though the company, through its directors, will carry business usually, it will require the permission of court in order to proceed with the disposal of substantial assets and other significant transactions.³⁹⁴

4.3.3 Insolvent trading

Insolvent trading is not specifically prescribed in any American legislation but there was an equivalent liability theory in the past which was developed and termed as deepening insolvency; which made it wrongful to allow a business which should have stopped trading, to continue to incur and amass more debts.³⁹⁵ The theory has now been discarded but has been continuously used as an argument against management in a few courts before its apparent demise.³⁹⁶

4.3.3.1 Penalties

The concept of damages for deepening insolvency is that there are times when a director's conduct, either fraudulently or negligently, reduces the life the corporation, thereby increasing

³⁹¹ Greenhow op cit (n148) 46.

³⁹² McCornack op cit (n174) 526.

³⁹³ Ibid.

³⁹⁴ McCornack op cit (n174) 518.

³⁹⁵ Farrar op cit (n141) 761.

³⁹⁶ Mindlin op cit (n374).

the corporation's debt and exposure to creditors. Managers owing a fiduciary obligation may be held personally liable for damages suffered by creditors.

4.3.3.2 Remedies

Under the business judgment rule, there is a belief that in the decision making process, the management must take into account all the relevant factors to be considered and ensure that the interests of the company is primed amidst other stakeholders. When directors have taken decisions thoughtfully, the courts will be more likely to adjudicate that their decisions are valid. In this way, the rule subtly allows the directors to have discretionary powers without being questioned about the intelligence of their decision in retrospection.³⁹⁷

³⁹⁷ American Bar Association op cit (n382) available at <http://www.americanbar.org/content/dam/aba/publications/blt/2010/09/inside-buslaw-insolvency-201009.authcheckdam.pdf>, accessed on 14 March 2016.

5. Chapter 4: Analysis and Recommendations

This Chapter will be the subject of recommendations to be proposed based on the critical analysis of the provisions analysed earlier in the previous chapter.

5.1 Australia

In Australia, corporate reorganisation is being done through a deed of arrangement. The main aim of such scheme is to promote the interests of both shareholders and creditors. Also, the regime caters for the remedial solutions in case the administrator and the directors become too close. These points will be considered below, together with the analysis of the business judgement rule not covering the insolvent trading decisions.

5.1.1 Deed of company's arrangement

By undertaking a deed of arrangement to pursue a rescheduling of debts, the expected results of the rescue proceedings are specifically elaborated upon, by enumerating the list of priorities and describing the manner in which the corporate salvation will be carried out. This mechanism is a very flexible one,³⁹⁸ catering for each case scenario and it will be up to the creditors to decide what options would be more convenient for effective rehabilitation proceeding. The notarial agreement can stipulate strategies which will align with the hierarchal objective of preserving the value of the business by ensuring its' going concern. The assenting administrator who is a party to the deed, should respect the targets which are anticipated to be achieved; otherwise in case of failure to follow the instructions or non-performance, he will be liable to contractual penalties.

The contracting parties towards whom the terms and conditions of the scheme will be binding, constitute of most of the important actors on whom the corporate rehabilitation might impact consequentially, namely the entity which will be represented by the directors, the shareholders of the company, the administrator and the creditors. Since the significant stakeholders have the opportunity to represent their rights sufficiently in the arrangement, there is less likely to be temptation stemming from each of them to influence the views of the administrator. In this way, the management will not doubt the intentions of the administrator

³⁹⁸ Farrar op cit (n97) 107.

about focusing on only certain groups of stakeholders and be willing to provide help to the administrator. Also, the executive officers will be contractually required to assist the administrator as per the terms of the deed, thus eradicating the threat of any resistance on the part of the managers. But on the other hand, it can be advanced that the administrator will be requiring the assistance of management and eventually he may have the tendency to be influenced by the directors. To limit the breeding of an over-familiar affinity between the two parties, it is advisable to put the creditors as the responsible party handling the ultimate supervision the business rescue process.

The execution deed of the company's arrangement encourages the practitioner to prioritise the interests of the creditors and to put in second place benefits of the other binding parties to the agreement. Thus, even if the company and its shareholders being unhappy about this ranking of rights, they cannot disrupt the reorganisation process because they were consenting to the agreement specifying the prioritisation. Furthermore, as the creditors will be supervising the execution meanwhile the deed is to be effective, their wishes are anticipated to be respected. However it can be refuted that the benefits of the creditors do not necessarily equate to the going concern of the company, thus misdirecting the administrator from its prime objective of saving the business.

The powers conferred to the administrator during the administration in Australia are subject to the terms integrated in the deed of company arrangement. The conditions of the agreement, including the terms relating to the appointment and role of the administrator, are therefore decided by the creditors of the company. It can be submitted that South African Companies Act should cater for the creditors to have the authority to determine the powers of the practitioner. As such there will be a better possibility for the creditors to influence the extent to which the rights of the practitioner can be safeguarded; and it will reduce any probable abuse of powers by the insolvency professional. Also, if the practitioner is inclined to promote any other interests than that of the company, the creditors are entitled to take appropriate measures to sanction the administrator. With creditors acting as a watchdog, the directors will be less pressurised to be dismissed from office by the practitioner, and will thus be able to do their job more efficiently without the need to compromise on their duties. In light of this argument, the proposal for the South African regulations to provide for more powers of

the creditors, by particularly entrusting them with the capacity to supervise the rehabilitation process, can be reiterated.

In the same fashion to the prerogatives of the administrator, the powers of the directors are ascertained by the same company's deed. The powers entrusted to the management will be largely based on the creditors' assessment of the directors' conduct before the company was placed under rescue regime.³⁹⁹ Therefore if the directors have been consistently been doing their job faultlessly, there are high chances that they would not be heavily penalised for insolvent trading, without their powers being expropriated away from them. In the event, some privileges of the managers are taken away from them, the creditors can revive the entitlements of the management partly or wholly as per their discernment. The directors may even be permitted to have a significant say in the formulation of strategic policies and participation in the decision making process. Since the managers are bound by the King Code principles and the provisions of the Companies Act, they will endeavour to promote the interests of creditors along with other stakeholders, and simultaneously direct the practitioner to follow the same approach.

5.1.2 Better returns for both shareholders and creditors

As provided by the section 435A of the Corporations Act, the aim of the administration regime is that if the continuity of the life of the entity cannot be ensured, a better return should be generated for both the creditors and members instead of what would have resulted from a spontaneous winding up. On the other side, the South African provision is more or less the same with the exception that the prioritisation of benefits should either be for the creditors or alternatively for the shareholders. It can be suggested that the South African legislature should amend the Companies Act to align with the Australian law, by reflecting that the interests of both the members and the creditors of the corporation should be safeguarded and maximized; resulting in the likelihood of friction emanating from the management towards the practitioner to be decreased. This is so because the directors will be reassured that the administrator is doing the job of the management by promoting the company's interests through the protection of the rights of the entity's owners. Also, there will be less pressure from the shareholders to remove the directors since they might perceive that the management has lobbied for their

³⁹⁹ Ibid.

wishes to be met and the officers have abided to their fiduciary duty owed towards them and the distressed entity.

5.1.3 Comfortable relationship between administrator and management

As mentioned in the previous chapter, in Australia, the creditors or the courts have the right to cease the administration of the administrator in the scenario where the specialist becomes too comfortable with the management. In order to ensure that practitioners do not influence the opinion of directors, or the other way round, which might have an impact on various stakeholders, especially the shareholders, the South African regulation have adopted a similar approach.⁴⁰⁰ In order to ensure that the interests of the company are protected by safeguarding the rights of its' members, as an affected party the shareholders can apply in terms of the Act to dismiss the managers in the case where there has been a loss of objectivity and independence on the part of these officers. Otherwise, directors might be induced by the bankruptcy practitioner to protect the rights of creditors and thus fail to apply the duty of fiduciary which they owe to the owners of the troubled entity.

5.1.4 Insolvent Trading and the Business Judgement Rule

As stated in the preceding chapter, the business judgement rule in Australia does not apply to insolvent trading.⁴⁰¹ Such an approach does not uphold management's use of discretion and judgement to continue trading; by supporting that it might be risky that as a result of leniency in the application of the rule, the liquidity situation of the business can be affected significantly. From a different perspective, Goode commented that managers 'can be faulted just as much for a premature cessation of trading as for continuing to trade while insolvent'.⁴⁰² The business judgement rule being not inclusive of the insolvent trading decisions will force directors to stop trading, which might bring more losses to creditors than if the officers continued to transact despite the liquidity difficulty of the entity.⁴⁰³ It can further be advocated that taking risks means more returns for the shareholders. Inciting the management not to take the risk of trading, where it is believed that to continue the corporate transactions would results in potential gains for the company, can equate to the returns of the shareholders

⁴⁰⁰ Section 139(1)(e) of the Companies Act stipulating that upon a court application by an affected party, the administrator can be removed on the ground of lack of independence.

⁴⁰¹ Farrar op cit (n141) 746.

⁴⁰² Campbell op cit (n333) 75.

⁴⁰³ Ibid.

through capital gains and dividend distribution being dwindled. Letting an opportunity of the distressed company to outdo financially would mean that there is the danger for the creditors in retrieving their investment in the business. So in this line of thought, not maximizing the benefits of creditors and shareholders go against the basics of a reorganisation regime.

Australia has adopted its' principles of business judgement rule mainly from the United States.⁴⁰⁴ Inopportunely, no extensive investigation has been probed into the American law and how to adapt the legal transplant conveniently.⁴⁰⁵ Aftermath, the fruits of the outcome was not as good as hoped.⁴⁰⁶ But the application of the rule in both jurisdictions is restricted to decisions strictly made only with respect to the business of the entity. However it should be appreciated that the South African judgement rule is extended to any decisions made the directors, including business decisions and those policies which are not related to the business of the entity.⁴⁰⁷ It can be deduced that the unrestrained application of the rule will enable directors to take decisions, without the compulsory approval of the practitioner. In this way, the directors not feeling intimidated by the consent and authority of the administrator, will be ready to assist the latter. As a counter argument, it can be defended that even though the wider the scope providing protection to directors for any of their actions, it can be argued that the officers can make wrong use of the rule and they can backed their decisions by documentary evidences which can be subject to manipulation.

5.2 United Kingdom

The hierarchal duties of the administrator during business rescue phase in the United Kingdom are similar to South African statutory provisions, except that the latter do not make express stipulation of the realisation of collateral for specific classes of creditors. The administration period in this particular jurisdiction is limited unlike the other countries which were covered in this project. The British approach does not trust the capabilities of the directors post insolvency and provides for the disqualification of these officers in this illiquidity circumstance. During the administration period, the administrator is given wide powers so that he can restore the financial position of the distressed entity to make it profitable. The extensive

⁴⁰⁴ Farrar op cit (n141) 761.

⁴⁰⁵ Ibid.

⁴⁰⁶ Ibid.

⁴⁰⁷ Cassim op cit (n83) 566.

prerogatives given will render the administrator proportionately accountable; which is why the decisions taken by him can be reviewed judicially. These peculiar characteristics will be analysed below.

5.2.1 Focus on creditors

The same aims of business rescue are set out in the South African legal framework with the exception of the third function of the administrator to realise the collateral for the returns of preferential and secured creditors. Since our research question does not cover the protection of different class of creditors per se, we will ignore that part. But it should be noted that the duty imposed on directors during the insolvency period is to prioritise the interests of the creditors, irrespective of their categories. With both the administrator and management having the same objective of promoting and maximising the returns of creditors, there is less likely to be reluctance on the part of managers to assist, curtailing the danger of probable conflicts which can arise between both parties.

Granted that the creditors are the most affected by the company being insolvent but it should be noted that the shareholders are also aggrieved by the worse off from the financial situation. The owners of the company generally experience a decrease in their capital gain since the value of the entity has decreased considerable due to the reputational loss. According to the Enterprise Act, there is no mention about the administrator protecting the rights of the members of the entity. Directors who are appointed by the shareholders, owe a fiduciary duty to the members even if the commitment is diminished with the financially distressed situation. Thus the administrator not being statutorily required to safeguard the interests of the shareholders, can act against the directorial obligation which can lead the management to be resistant to help the administrator.

5.2.2 Short duration of administration

The time limit of the administration under the Enterprise Act is 12 months. The advantage of such a time constraint implies that the troubled company needs to be rescued without undue delay. The rationale behind such a time frame is the sooner the corporate rehabilitation takes place, the better the company will recover and start to trade normally back again. Nonetheless it can be advanced that it takes time before a distressed entity can recover

from the public disgrace and improve the operational situation. To execute reorganisation strategies can be done very fast but to see the results of it, can take more than one year. Therefore putting such a tight deadline to assess the outcome of the rescue process can be unrealistic. But at the same time, not putting a time limit can allure the administrator to delay his response to the restructuration process which can affect the success of the regime. Thus it can be proposed that the South African law can provide a similar mechanism of putting a reasonable time frame within which the rescue proceedings should be effective and come to term.

5.2.3 Wide powers and Judicial Review of decisions of the administrator

Given that the administrator is empowered to dismiss the directors at any time during his administration, there is a possibility that there will be a tensed relationship between them. Also, as the administrator has the right to bring a claim for summary judgement against the management for breach of duties, there will be tendency from the directors to be providing the administrator with only the basic assistance. They will not try to go out of their way to give an insight to the administrator about the inherent environment and the mechanism of the business, which can potentially affect the restructuring process negatively. Moreover, they might window dress information in such a way to ensure that the administrator does not discover their breach of duty. On the other side, the administrator having such wide powers, implicates he can make wide use of his discretion.⁴⁰⁸ However in the presence of monitoring institutions, he may abandon his faculty of making value judgement because he might be reported to have has an adverse behaviour.⁴⁰⁹ He might perceive this privilege as an additional duty which will be strictly assessed instead of the discretionary faculty being a power in the proper sense.⁴¹⁰

In the British jurisdiction, the administrator has to justify why he prefers to adopt a specific strategy rather than the others. This ensures that the benefits of most stakeholders are taken into account; and if not, explanation should be provided. Such a duty imposed on the insolvency expert decreases the degree to which he might focus on other personal motivations or for opting for a particular and biased cause of action. In spite of the clarifications given, if the aggrieved party is not satisfied with the justification of the strategy adopted, it can consider

⁴⁰⁸ Wheeler op cit (n166) 301.

⁴⁰⁹ Ibid.

⁴¹⁰ Ibid.

to apply to court to have the decision of the practitioner being reviewed. However the issue which may be encountered by the Court in determining the correctness of the decision taken is that strategies are taken with respect to the circumstances of the entity. Since the Court is not acquainted to the business' culture and operations, it might be difficult to make an accurate and appropriate determination. Therefore, it can be suggested that the South African law should include the accessibility of any aggrieved party, integrating not only shareholders and creditors but also employees, the public and the supporters of environment to seek the review of the decision of the practitioner before the Court, if they have been affected by the policy adopted.

5.2.4 Disqualification of directors

It was experienced that the concept of wrongful trading will act as 'a potential catalyst' to change the managerial comportment in the long run.⁴¹¹ The risk of losing the shield of limited liability if the managers undertake transactions in an insolvent situation, will entice these officers to improve their directorial behavior.⁴¹² Any enhancements in the standard of conduct will directly impact the reorganisation proceedings, with more capable directors to keep updated with the progress of the proceedings and to be informed about new information which altogether will give the officers the insight to rectify the corporate issues.⁴¹³

It can be defended that the imposition of the directors' disqualification might discourage the management to use its' discretion to take decisions. Moreover, the managerial debarment signifies that the freedom given to the executive officers in taking a decision under the business judgement rule is being undermined.⁴¹⁴ Under the threat that court will scrutinise their decisions and try to second-guess the reasoning for opting for a particular decision, directors will be reluctant to take risks on behalf of the entity so as to avoid being disqualified.⁴¹⁵ By anticipating the possibility of prosecution, the directors may be tempted to keep records of the board minutes so that they can produce the documentary evidences to prove that the strategies chosen are justified.⁴¹⁶ Thus it can be said that such an approach does not induce directors to freely communicate or advice the administrator in case the latter requires assistance.

⁴¹¹ Campbell op cit (n333) 74.

⁴¹² Ibid.

⁴¹³ Ibid.

⁴¹⁴ Girgis op cit (n335) 704.

⁴¹⁵ Ibid.

⁴¹⁶ Greenhow op cit (n148) 57.

5.3 United States of America

In America, the directors remain in control of the business operations and decision making process during the insolvency period. The managers formulate strategic policies to be adopted in the rescue period so as to bring the troubled company back in the profitable phase. However, after a certain time, the creditors' committees can propose schemes to be implemented as part of the rescue plan. If the directors believe that they will not be able to reconstitute the corporate health of the distressed entity, they can have recourse to the assistance of a supervisor which is usually a trustee. Irrespective of the liquidity status or the appointment of the trustee, the managers are tacitly required to exercise their duty in good faith. In certain circumstances, the doings of the executive officers will be subject to the approval or under the oversight of the Court. The mentioned points will be studied below.

5.3.1 Management staying in control but subject to the supervision

The advantage of the approach adopted in the United States is that the management stays in control even if the company encounters cashflow complications. The attitude integrates promptness of action which is essential for an effective financial recovery, whereby even if the company has not fallen into the insolvency zone, remedial measures are carried out to improve the situation. Further, the manoeuvre places reliance on the capability of directors capable to restore the financial position of the entity who might occasionally require help. This is why the supervision of the judiciary is required, so as to ensure that major transactions are not undertaken without its' approval. As a consequence, directors being left in control with the same executive responsibility together with the supervision of the Court, will result in an effective corporate restructuration. However it has been argued that the extent of the court's involvement with respect to the reorganisation of debts is not clear during the period the entity continues to trade.⁴¹⁷ Even if the Court interferes during the restructuration phase, it will attempt to make orders which are contradictory to the functions and commitments of the management. In pursuance of the conflict perspective, it can be inferred that since no rescue practitioner will be appointed, there will no clashes arising with respect to the duties of the directors.

⁴¹⁷ Rochman op cit (n15) 51.

Subsequent to serious cases of gross mismanagement, the directors will no longer have the entire corporate control and accordingly the officer of the government, the trustee will be appointed. Practically the trustee will be attorneys which means they are very well accustomed to the bankruptcy law and will adopt remedial measures which do not or have less legal negative consequences. As a comparison, in South Africa, the insolvency practitioner can be an attorney but it need not be one or have a legal qualification. A professional having expertise from another sphere will tend to perceive things differently and might implement policies which provoke legal risks. As a result, it can be proposed that South Africa provides that the insolvency specialist should have a legal background preferably and if it not, the person should have adequate experience in other related insolvency areas. Such a recommendation would ensure that even if there is any dispute arising from the practitioner and the directors, the bankruptcy specialist can substantially back his suppositions due to his qualifications and/or expertise, especially by explaining how a legal contravention can impact damagingly the company reputation and the rescue regime. The justifications to be provided will diminish the differences between the parties.

Also, there are advisors who are appointed to make recommendations based on their area of specialisation, with regards to the corporations' circumstances. With different professionals with various fields of expertise, the managers will have more appropriate solutions to improve the financial health of the company compared to the insolvency practitioner who although is acquainted to several fields of the insolvency law, does not possess the requisite expertise in all the relevant fields. It is an option that South Africa considers a move from the administrator having the full control over the corporate management towards a system where the directors are entitled the same prerogatives but certain dealings transacted by them require the approval of the Court and the advice of competent experts in the specific field, as required on a case to case basis, instead of having a practitioner with wide and discretionary powers.

5.3.2 Creditors' power

Like all the jurisdictions considered earlier in the research project, even in United States, the management focus shifts from the benefits of the shareholders to that of creditors during the insolvency phase. It can be defended by the owners of the business that they are affected by such an approach and since the directors are still appointed by the shareholders, these members

are entitled to remove the management from office. It can be concluded that there might be reservations on the part of directors to maximise the returns of the creditors at the detriment of the members of the distressed entity.

By undertaking transactions recklessly, there is a risk that creditors will not get back their investments if the company falls in an aggravated financial downfall. The American bankruptcy laws do not cater for the penalisation of insolvent trading, there is also no liability on directors in case of fraudulent trading.⁴¹⁸ This theory goes more in line with the protection of the directors' judicious decision making ability and the promotion of the business judgement rule. However it can be argued that creditors being the most affected by any fraudulent transactions, can have recourse to safeguard their rights through contract.⁴¹⁹ The legal instrument enables the creditors to protect their rights sufficiently during the restructuring process; together with the board of directors converging its actions towards the safeguard of the returns of the shareholders and creditors as per their fiduciary and contractual duty. It is worth noting that there is a mechanism provided in Section 155 of the South African Companies Act whereby a compromise can be reached between the entity and its' creditors as an alternative to the rescue process.⁴²⁰ This compromise can be entered irrespective of the solvency situation of the entity, except if the creditors have expressly opted for a rescue proceeding.⁴²¹

By way of conclusion, it can be said that since the creditors' committee can influence some of the managerial decision making processes, it means that they are better empowered to secure the protection of their rights through the period the company is placed under business rescue proceedings. This ensures that the party which is the most aggrieved by the reputational loss suffered by the entity, can be actively involved in strategic planning to ensure that they can limit their damages. As advanced previously, the South African regulation can provides for more powers of creditors which will lessen the powers of practitioner. This change will can result in directors being induced to help the administrator, given that they both have equal powers with respect to the way the rescue proceedings will proceed.

⁴¹⁸ Purslowe op cit (n296) 120.

⁴¹⁹ Ibid.

⁴²⁰ Cassim op cit (n2) 909.

⁴²¹ Section 155(1).

5.3.3 Limited powers of supervisor

As mentioned earlier, the supervisor is considered to be like an administrator with limited powers which implies that the directors are not explicitly required to follow the orders of the trustee. There is the risk that the measures proposed by the trustee which has not been abided by the management were essential for the rescue proceedings. Subsequently it might lead to an inefficient reorganisation plan, due to the fault of the directors and the trustee being unable to impose its' prerogatives. But on the other hand, limited powers of the supervisor would imply that the latter cannot sack remove the directors from office. With this threat of removal is eliminated, the managers will be more willing to assist the supervisor whenever it is required. As such, it can be said that curtailing the powers of the practitioner in the South African legal framework can lead diminish the jeopardy of conflicts arising between the supervisor and the directors.

5.3.4 Duty of good faith

The South African provision expressly stipulates that a director should perform his duties in good faith.⁴²² As such there is an express duty on part of the management to undertake dealings in good faith. If the director fails to prove his good faith due to insufficient evidential proof, he will be subject to harsh penalties and even removal from office. After being dismissed from the company, directors being the most resourceful persons from which the business rescue practitioner can obtain information from, will be reluctant to assist the insolvent professional which might lead to a poor rehabilitation mechanism. If the principle adopted in the United States is applied by South Africa, in the way that good faith is implied and it not expressly instructed to be followed, the evidential burden will be less by the directors to prove their noble intentions. With this approach, directors will be encouraged to make business judgements and decision without the fear of being questioned about the logic behind the strategy formulation. Nonetheless, it should be highlighted that the effectiveness of the American business judgement rule advocates that 'reasonable diligence and care have been exercised'.⁴²³ Thus it can be deduced that only competent directors can seek remedy under this defence, which is also the case in South Africa.⁴²⁴

⁴²² Section 76(3)(a).

⁴²³ Finch op cit (n336) 189.

⁴²⁴ Ibid.

6. Conclusion

This thesis researched into the question of whether the duties and powers provided by the South African law during the business rescue proceedings would lead to conflicts with respect to the duties and powers of the directors.

It can be concluded that from the Companies Act 1973 to the current Act 2008, there has been a move from management displacement to a tendency towards a debtor company in possession, although we are far from having such kind of regime. We have analysed whether the present statutory provisions might cause frictions between the business rescue practitioner and the directors since both of them form part of the management during the period the reorganisation proceedings of the distressed entity have been initiated.

In this research project we have considered that the practitioner having the effective managerial control whilst the directors having a lesser control over the directorial powers during the corporate rehabilitation period which could lead conflicts between the two parties. The risk of frictions between the parties can be felt when the practitioner might require the assistance of the managers of the distressed corporation in order to have an overview of the internal operations of the business or to have the latter's guidance about the whereabouts of the records and the provision of relevant documents, base on which the practitioner will proposed strategic policies. With different aims, focus, motivations, perceptions and expertise, the management will be reluctant to assist the practitioner accordingly. Consequently, there will be possibility of distortions in the flow of information which will in turn result in the important data not properly taken into consideration, leading to an inefficient restructuring regime which can lead to the winding up of the company.

We have subsequently compared the similar statutory provisions of Australia, United Kingdom and the United States respectively. Based on these provisions, juxtaposed to those ones stipulated in the South African legal framework, we have made some recommendations. One of the proposals is that the creditors of the distressed entity, who are the most affected by the business failure, should be given the power to supervise the way the administration is being carried out. This can be done through the company, which can adopt a deed of arrangement

whereby the creditors can decide on the privileges to be empowered to the practitioner and directors during the corporate reintegration period. Further it has been advanced that both the interests of creditors and shareholders are to be prioritised instead of having the alternate option of promoting only the benefits of one of these parties.

Given the wide powers of practitioners during the business rescue process in South Africa, it has been suggested that if an affected party is not convinced with the justifications of the choice of strategies, it should be entitled to apply to court for judicial review. A provision in that respect, stipulating that at any aggrieved stakeholder has the right to apply to court to ask for the review of the decision made by the bankruptcy specialist. However the court will have to ensure that the interests of the applicant or plaintiff were seriously affected. Even if South Africa has not adopted the mechanism whereby the management still has full directorial control, maybe the legal framework should be drafted in such a way as to encourage directors to improve the financial position of the company and when they are unable to do so, as a last resort to appoint the practitioner who will assist them.

In light of the above propositions, it is also to be noted that South African should undertake thorough investigation on the applications of these policies in the respective foreign jurisdictions. Identical legal transplantation can prove to be disastrous if they are implemented without due enquiry. The countries which we have considered in the course of the research have different economic and social climate and the national legal framework also varies. Therefore South Africa should research how it can best modify and apply those recommendations. Accordingly, it will benefit from both the advantages of having the expertise of the practitioner who is better placed to save the company from liquidation coupled with the benefit of still forming part of the directorial control by retaining the privileges of actively participate in the decision making process. As a result, there will be less risk of frictions and frustrations arising between the practitioner and management, leading to an effective and successful corporate rehabilitation.

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